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In The

Supreme Court of the United States

UNITED STUDENT AID FUNDS, INC.,

Petitioner,

v.

FRANCISCO J. ESPINOSA,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Student loans are statutorily non-dischargeable in bankruptcy unless repayment would cause the debtor an "undue hardship." Debtor failed to prove undue hardship in an adversary proceeding as required by the Bankruptcy Rules, and instead, merely declared a discharge in his Chapter 13 plan. Are the orders confirming the plan and discharging debtor void?

2. Bankruptcy Rules permit discharge of a student loan only through an adversary proceeding, commenced by filing a complaint and serving it and a summons on an appropriate agent of the creditor. Instead, debtor merely included a declaration of discharge in his Chapter 13 plan and mailed it to creditor's post office box. Does such procedure meet the rigorous demands of due process and entitle the resulting orders to respect under principles of res judicata?

RULE 29.6 STATEMENT

Petitioner United Student Aid Funds, Inc. is a private nonprofit corporation established under the laws of the State of Delaware. It has no parent company, and no publicly held company holds any membership interest in it. Its members are the individuals on its Board of Trustees.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner United Student Aid Funds, Inc. respectfully prays that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Ninth Circuit, filed in the above-entitled proceeding on December 10, 2008.

OPINIONS BELOW

The memorandum decision of the United States Bankruptcy Court for the District of Arizona (App. 71, *infra*) and the order of the United States District Court for the District of Arizona (App. 60, *infra*) are unreported. The opinion of the court of appeals remanding for additional findings (*Espinosa I*, App. 51, *infra*) is reported at 530 F.3d 895. The opinion of the court of appeals following remand (*Espinosa II*, App. 28, *infra*) is reported at 545 F.3d 1113. The amended opinion of the court of appeals following denial of rehearing (*Espinosa III*, App. 1, *infra*) is reported at 553 F.3d 1193.

JURISDICTION

The original opinion of the Court of Appeals for the Ninth Circuit was filed on October 2, 2008. A timely petition for rehearing *en banc* was denied and an amended opinion was filed on December 10, 2008.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

11 U.S.C. § 1325. Confirmation of plan.

(a) [T]he court shall approve a plan if –

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title.

11 U.S.C. § 1327. Effect of confirmation.

(a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.

11 U.S.C. § 1328. Discharge.

(a) As soon as practicable after completion by the debtor of all payments under the plan, . . . the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt –

. . . .

(2) of the kind specified in paragraph . . . (8) . . . of section 523(a) of this title. . . .

11 U.S.C. § 523. Exceptions to discharge.

(a) . . . (8) for an educational . . . loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, . . . unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.

STATEMENT OF THE CASE

This case raises an important question, which courts have observed is recurring with increasing frequency, regarding the propriety of the debtor-created tactic for obtaining a bankruptcy discharge of a student loan, known as a "discharge-by-declaration," without proving "undue hardship" as required by statute, and without commencing an adversary proceeding and giving the creditor individual notice by service of a summons and complaint as required by bankruptcy court rules.

In 1988-89, respondent Francisco J. Espinosa obtained four student loans totaling $13,250 through the Federal Family Education Loan Program ("FFELP"). His loans were government guaranteed. In 1992, Espinosa filed a Chapter 13 bankruptcy petition that listed his student loans as his only debts. At that time, Espinosa's notes were held by petitioner United Student Aid Funds, Inc. ("USA Funds").

Espinosa's proposed plan provided for payment over time of only the principal amount of his loans, and declared that "[a]ny amounts or claims for student loans unpaid by this Plan shall be discharged." In other words, all accrued and post-petition interest would be discharged under the plan. Although student loans are non-dischargeable except in circumstances of "undue hardship," which the Federal Rules of Bankruptcy Procedure require the debtor to prove in an adversary proceeding, Espinosa failed to commence an adversary proceeding to seek a discharge of his student loan interest debt. The plan made no mention that Espinosa would suffer "undue hardship" if the accrued and accruing interest on his debt was not discharged. It simply declared a discharge.

Notice of the case and the plan was given to USA Funds only by mail at the post office box address used to receive loan payments. Espinosa did not serve the plan on a USA Funds' officer, managing or general agent, or other agent authorized to receive service of process, as a summons and complaint in an adversary proceeding against a corporation must be served.

USA Funds filed a proof of claim for $17,832, to which Espinosa did not object. USA Funds did not object to the plan, which the court confirmed in 1993 without any finding of undue hardship. The confirmation order made no express mention of Espinosa's student loan debt. After confirmation of the plan, the trustee gave notice to USA Funds that its claim differed from the amount listed in the plan and would

be paid according to the plan unless such treatment was disputed.

Espinosa paid pursuant to the plan, and a standard discharge order was entered in 1997. That order excepted from discharge any debt "for a student loan . . . as specified in 11 U.S.C. § 523(a)(8)."

Espinosa's loans were subrogated to the United States Department of Education pursuant to a reinsurance agreement. In 2000, the Education Department commenced collection efforts, and caused the Treasury Department to intercept Espinosa's income tax refunds. In 2003, Espinosa filed a motion alleging violation of the discharge injunction. USA Funds recalled the loans from the Education Department and moved under FED. R. CIV. P. 60(b)(4) for relief from the confirmation order on the ground it is void. The bankruptcy court ruled for Espinosa. USA Funds appealed to the district court, which reversed, ruling that the confirmation order is void for lack of due process and therefore had no res judicata effect.

Espinosa appealed to the Ninth Circuit. That court remanded to the bankruptcy court for a determination whether exclusion of Espinosa's student loan debt from the discharge order was a clerical error. (*Espinosa I.*) The bankruptcy court ruled that it was. (App. 4-5, *infra.*) The court of appeals then reversed the district court. In an opinion authored by Chief Judge Kozinski, it was held that a debtor may obtain discharge of a student loan by merely including it in a Chapter 13 plan, without proving undue

hardship in an adversary proceeding, if the creditor fails to object to the plan. Therefore, the orders confirming Espinosa's plan and discharging his debt were held to be valid and final. (*Espinosa II.*) USA Funds petitioned for rehearing *en banc*, which the court denied with an order amending its opinion. (*Espinosa III.*)

Jurisdiction in the proceedings below was granted to the bankruptcy court by 28 U.S.C. §§ 151 and 157(b), to the district court by 28 U.S.C. § 158(a)(1), and to the court of appeals by 28 U.S.C. §§ 158(d)(1) and 1291.

REASONS FOR GRANTING THE WRIT

The decision of the Ninth Circuit allows student loan debtors to discharge their debts in bankruptcy without proving "undue hardship," contrary to the statutory requirement recognized by this Court. The Ninth Circuit is the only court of appeals to permit this result; five others reach the opposite conclusion on indistinguishable facts. The decision below is not merely erroneous, it is intolerable given the necessity of national uniformity in bankruptcy law. In view of the circuit split and the Ninth Circuit's refusal to adopt the prevailing view, only this Court can resolve this recurring issue.

I. The Ninth Circuit's decision conflicts with principles expressly recognized in this Court's ruling in *Tennessee Student Assistance Corp. v. Hood.*

This Court has previously recognized that Congress intended to make it more difficult for debtors to discharge student loans, and that the statutes and Bankruptcy Rules provide that such loans are not discharged unless the bankruptcy court, through an adversary proceeding, expressly determines that excepting the debt from discharge would impose an "undue hardship":

> Student loans used to be presumptively discharged in a general discharge. But in 1976, Congress provided a significant benefit to the States by making it more difficult for debtors to discharge student loan debts guaranteed by States. That benefit is currently governed by 11 U.S.C. § 523(a)(8), which provides that student loan debts guaranteed by governmental units are not included in a general discharge order unless excepting the debt from the order would impose an "undue hardship" on the debtor.
>
> Section 523(a)(8) is "self-executing." Unless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt.
>
> . . . .
>
> Creditors generally are not entitled to personal service before a bankruptcy court

> may discharge a debt. Because student loan debts are not automatically dischargeable, however, the Federal Rules of Bankruptcy Procedure provide creditors greater procedural protection. The current Bankruptcy Rules require the debtor to file an "adversary proceeding" against the State in order to discharge his student loan debt. . . . [A]s prescribed by the Rules, an "adversary proceeding" requires the service of a summons and a complaint.

Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440, 449-452 (2004) (internal citations omitted).[1]

While the Ninth Circuit recognized that USA Funds was making precisely the same "statutory" argument found in *Hood*, it held that its own decision in *Great Lakes Higher Educ. Corp. v. Pardee* (*In re Pardee*), 193 F.3d 1083 (9th Cir. 1999), "forecloses this argument." App. 6-8, *infra*. The essence of *Pardee*, as the Ninth Circuit states, is that a discharge order is a final judgment. *Id.*

The Ninth Circuit also recognized that USA Funds relied "heavily" on *Hood*, but dismissed that authority because "the Supreme Court recognized in

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[1] Certiorari was granted in *Hood* to determine whether the Bankruptcy Clause gives Congress the authority to abrogate States' immunity from private suits. 541 U.S. at 443. Without reaching that question, *Hood* upheld the application of the Bankruptcy Code to adversary proceedings initiated by a debtor against a state guaranty agency to determine the dischargeability of a student loan debt. 541 U.S. at 451.

Hood that an adversary proceeding initiated by complaint and summons is not a statutory or constitutional prerequisite to adjudication of the discharge of a student loan." App. 17-18, *infra*, quoting KEITH M. LUNDIN, *Chapter 13 Bankruptcy* § 346.1 (3d ed. 2000 & Supp. 2004).

Although *Hood* observed that "[t]he text of § 523(a)(8) does not require a summons, and absent Rule 7001(6) a debtor could proceed by motion, . . . which would raise no constitutional concern," 541 U.S. at 453, what the court of appeals failed to recognize is that *Hood* does not sanction discharge-by-declaration and instead affirmed that "the Bankruptcy Court cannot discharge [student loan] debt without making an undue hardship determination." 541 U.S. at 453-454. "[T]he *Hood* Court's suggestion, in an entirely different context, that a debtor could proceed by motion in the absence of the Bankruptcy Rules does not authorize debtors to ignore the requirements of the Rules." *In re Hanson*, 397 F.3d 482, 487 (7th Cir. 2005).

It is therefore clear that the Ninth Circuit has decided an important and recurring federal question in a way that conflicts with a relevant decision of this Court. However that result occurred, whether through misconstruction, misapplication, or misconception of *Hood*, it cannot stand.

II. The Ninth Circuit has decided an important and recurring issue of bankruptcy law in a manner that conflicts with rulings of the Second, Fourth, Sixth, Seventh and Tenth Circuits.

A. The circuits expressly acknowledge the conflict.

By its decision, the Ninth Circuit has isolated itself and created a geographically-based dual system of bankruptcy law in which student loan debtors and creditors have different rights, and may or must use different procedures, regarding the discharge of student loan debt, depending on where the debtor is located.[2]

The conflict was expressly recognized by the Ninth Circuit: "Two circuits [citing the Second and Tenth] have disagreed with *Pardee*, and accepted USA Funds's statutory argument." (App. 8, *infra*.) "While we are bound by *Pardee*, we have taken a close look at the contrary holdings of our sister circuits. . . ." (App. 17, *infra*.) "Three circuits [citing the Fourth, Sixth and Seventh] have held . . . that a student loan debtor's failure to commence an adversary proceeding

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[2] The decisions in conflict with the Ninth Circuit are *Banks v. Sallie Mae Servicing Corp. (In re Banks)*, 299 F.3d 296 (4th Cir. 2002); *In re Hanson*, 397 F.3d 482 (7th Cir. 2005); *Ruehle v. Educational Credit Mgmt. Corp. (In re Ruehle)*, 412 F.3d 679 (6th Cir. 2005); *Whelton v. Educational Credit Mgmt. Corp.*, 432 F.3d 150 (2d Cir. 2005); and *Educational Credit Mgmt. Corp. v. Mersmann (In re Mersmann)*, 505 F.3d 1033 (10th Cir. 2007).

by serving the student loan creditor with a complaint and summons, denies the creditor due process." (App. 18, *infra*.) "It is thus fair to say that our position in *Pardee* is in the minority; indeed, among the circuits we now stand alone." (App. 56, *infra*.)

In re Mersmann, the most recent of the conflicting decisions cited by the Ninth Circuit, observes that "only [the Ninth Circuit] . . . permit[s] discharge-by-declaration." 505 F.3d at 1045 (citing *Pardee*). In opposition, according to *Mersmann's* survey of the cases, stand the Second, Fourth, Sixth, and Seventh Circuits. *Id*. at 1046-47. The Tenth Circuit joined that majority in *Mersmann* by adopting the reasoning of the other circuits and rejecting discharge-by-declaration. *Id*.

Express recognition of the conflict within the circuits as it was emerging and widening is also found in *In re Banks*, 299 F.3d at 299, 301; *In re Repp*, 307 B.R. 144 (B.A.P. 9th Cir. 2004), *rev'd, Espinosa II* and *III*; *In re Hanson*, 397 F.3d at 485; *In re Ruehle*, 412 F.3d at 683-84 (stating that *Banks* and *Hanson* "represent an evolving majority view"); and *Whelton*, 432 F.3d at 153.

The conflict between the Ninth and five other circuits is therefore clearly pronounced.

The fact pattern of the cases across the circuits parallels the facts here. Each case involved a Chapter 13 bankruptcy in which the debtor proposed a plan that would, by varying language, effect a discharge of student loan debt by mere declaration.

Notice of the plans was given to creditors, who did not object. No adversary proceedings were commenced, and no showing or ruling of undue hardship was made. Despite the obvious violations of the Bankruptcy Code and Rules, the plans were confirmed. No appeal was taken from the confirmation orders or the subsequent discharge orders. Thus, the Ninth Circuit characterizes the cases as "similar." App. 23, *infra*. Indeed, they are substantially indistinguishable.

Notably, *Mersmann* overruled *Andersen v. UNIPAC-NEBHELP* (*In re Anderson*), 179 F.3d 1253 (10th Cir. 1999), the seminal case the Ninth Circuit followed in *Pardee*. Given the Ninth Circuit's refusal in this case to overturn *Pardee*, as the Tenth Circuit did *Andersen*, there is no point in waiting any longer for the Ninth Circuit to eliminate the conflict with its sister circuits.

Neither is there reason to await future cases in other circuits before resolving the clearly existing conflict. Every circuit that has considered the issue of discharge-by-declaration since *Andersen* and *Pardee*, except the Ninth, has rejected that debtor's ploy. It is therefore clear that a prevailing rule has emerged.

B. The issue presented by the conflict is recurring and of substantial national importance.

The Ninth Circuit's decision has set the national stage for continued disparate treatment of the significant issue of discharge of student loans by declaration. Student loans are prevalent and their total dollar magnitude is substantial.[3] At the same time, personal bankruptcy filings are escalating.[4] Recurrence of the issue is therefore certain. Indeed, experience teaches that debtors in circuits that have yet to decide the issue will seek to discharge student loan debt through the gambit of discharge-by-declaration. As the Fourth Circuit observed in *Banks*: "The number of Debtors seeking to improperly discharge nondischargeable debt increased significantly following the decisions of our sister Circuits in *In re Andersen* and *In re Pardee*. *See* [*In re Evans*, 242 B.R. 407 (Bankr.S.D. Ohio 1999)] (citing cases and noting

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[3] "The federal student financial assistance programs involve more than 6,200 postsecondary institutions, more than 3,100 lenders, 35 guaranty agencies, and many third-party servicers. During FY 2008, Federal Student Aid (FSA) provided $96 billion in awards and oversaw an outstanding loan portfolio of more than $500 billion." U.S. DEPT. OF EDUC., FINANCIAL AND PERFORMANCE QUARTERLY UPDATE, Issue 2008-2, at 7 (Sept. 30, 2008).

[4] Non-business bankruptcy filings increased 31 percent in 2008 compared to 2007, and also increased in 2007 over 2006. ADMIN. OFFICE OF THE U.S. COURTS, News Release, BANKRUPTCY FILINGS UP IN CALENDAR YEAR 2008 (Mar. 5, 2009), www.uscourts.gov/Press_Releases/2009/BankruptcyFilingsDec2008.cfm.

frustration with the trend)." 299 F.3d at 301. Needless to say, this situation will persist until this Court settles the question.

In addition to the fact that issues of bankruptcy law are, by their very nature, of national importance, the significance of the current conflict among the circuits is underscored by the Bankruptcy Clause of the Constitution, which gives Congress the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. CONST. art. I, § 8, cl. 4. This Court monitors those laws for uniformity. *See Hanover Nat'l Bank v. Moyses*, 186 U.S. 181 (1902). Likewise, the Court should monitor and ensure that the uniform laws are uniformly applied. "The Constitutional requirement of uniformity . . . is wholly satisfied when existing obligations of a debtor are treated alike by the bankruptcy administration throughout the country. . . ." *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 172 (1946).

The discharge of student loan debt is also a matter of public importance. The improper discharge of non-dischargeable student loan debt harms the public in general because unpaid government guaranteed student loans are ultimately paid by all of us as taxpayers.

Finally, the tactic of discharge-by-declaration threatens to transcend its application to student loans. If not abolished, use of the tactic could spread to other presumptively non-dischargeable debts such as child support, alimony, fines, and taxes. *Pardee*

avoided addressing the issue in such other contexts. 193 F.3d at 1087, n. 6.

III. The decision below is incorrect.

A. Discharging student loan debt through mere declaration in a Chapter 13 plan without proving "undue hardship" through an adversary proceeding violates the Bankruptcy Code and Rules and is therefore void.

Although Espinosa proposed a plan that did not comply with the Bankruptcy Code, and the bankruptcy court's approval of the noncompliant plan was also contrary to the Code, the Ninth Circuit nevertheless held that the discharge order was not void because USA Funds had not objected to the plan. App. 8, *infra*. That decision is erroneous because it ignores Congress' clear intent to severely restrict student loan discharges and prohibit approval of Chapter 13 plans that do not comply with that restriction. *In re Mersmann*, 505 F.3d 1033; *Whelton*, 432 F.3d 150.

To fully appreciate and give effect to the intent of Congress, it bears repeating that educational loans, which formerly were readily dischargeable, are now presumptively non-dischargeable in bankruptcy. Since 1976, Congress has made it increasingly more difficult to discharge student loan debts. *Hood*, 541 U.S.

at 449, citing statutory amendments.[5] The objective is to preserve the student loan program and "assure future generations of students will also have an educational loan available. . . ." 125 CONG. REC. S. 9160 (daily ed. July 11, 1979) (remarks of Sen. DeConcini). The Bankruptcy Code now allows discharge for one – and only one – reason, namely, that "excepting such debt from discharge . . . will impose an undue hardship on the debtor." 11 U.S.C. § 523(a)(8).

This Court has recognized that § 523(a)(8) is "self-executing." *Hood*, 541 U.S. at 450. Therefore, "[u]nless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt." *Id.* "Simply embedding a 'meaningless incantation of undue hardship' in a confirmation plan falls short of the 'affirmative' action required by Congress and the Supreme Court." *In re Mersmann*, 505 F.3d at 1048. Likewise, any reason for discharge that is merely proclaimed in a plan is ineffective.

The exclusive procedure for determining the dischargeability of a debt is an adversary proceeding. FED. R. BANKR. P. 7001(6). In other words, "under 11 U.S.C. § 1328(a) the Bankruptcy Court lack[s] the authority to grant a discharge of . . . student loan

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[5] A review of the "progressively more restrictive" requirements for student loan discharge is found in *In re Mersmann*, 505 F.3d at 1042.

debt through the ordinary confirmation process." *Whelton*, 432 F.3d at 154-55.

Because post-petition interest on student loan debt is also non-dischargeable, *Bruning v. United States*, 376 U.S. 363 (1964), a debtor seeking its discharge must also bring an adversary proceeding. *E.g.*, *In re Banks*, 299 F.3d at 300.

"An adversary proceeding is treated as a separate dispute between the Debtor and Creditor. . . ." *In re Banks*, 299 F.3d at 296. It is an "individualized determination." *Hood*, 541 U.S. at 450. The adversary proceeding is modeled on the traditional civil litigation format, either incorporating or adapting most of the Federal Rules of Civil Procedure. FED. R. BANKR. P. 7001, Advisory Committee Notes. Accordingly, an adversary proceeding is commenced by the filing of a complaint, *id.*, R. 7003 (incorporating FED. R. CIV. P. 3), which must then be served with a summons, *id.*, R. 7004.[6]

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[6] The burden of proving undue hardship is on the debtor. *E.g.*, *Rifino v. United States* (*In re Rifino*), 245 F.3d 1083, 1087-88 (9th Cir. 2001). To determine if excepting student loan debt from discharge will impose an undue hardship, most circuits apply the three-part test first enunciated in *In re Brunner*, 831 F.2d 395, 396 (2d Cir. 1987), and adopted by the Ninth Circuit in *United Student Aid Funds, Inc. v. Pena* (*In re Pena*), 155 F.3d 1108, 1112 (1998). Under the *Brunner* test, the debtor must prove that (1) he cannot maintain, based on current income and expenses, a "minimal" standard of living for himself and his dependents if required to repay the loans; (2) additional circumstances exist indicating that this state of affairs is likely to

(Continued on following page)

Because student loan debts may only be discharged upon a finding of undue hardship, a plan that merely declares that such a debt will be wholly or partially discharged upon completion of the plan does not comply with the Code and the Rules, and therefore may not be confirmed. Congress has expressly instructed that plans that do not comply with the Code are not to be approved:

> [T]he court shall approve a plan if –
>
> (1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title.

11 U.S.C. § 1325(a). *Accord*, *In re Mersmann*, 505 F.3d at 1048 ("§ 1325(a)(1) of [the] Code permits the confirmation of a plan *only* if it is consistent with the rest of the Code"). *Mersmann* therefore concluded that "a bankruptcy court lacks authority to confirm a plan provision that seeks to discharge a student loan debt without an adversary proceeding proving 'undue hardship.'" *Id.*, at 1049.

Failure to comply with the Code has been said to render the plan and any confirming order "nugatory." *In re Hanson*, 397 F.3d at 487, citing *In re Escobedo*, 28 F.3d 34, 35 (7th Cir. 1994). Otherwise stated, the

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persist for a significant portion of the repayment period; and (3) the debtor has made good faith efforts to repay the loan. Thus, the barriers to discharge of student loan debt are high, no doubt explaining why debtors attempt to discharge student loan debt by declaration.

offending provision for discharge of student loan debt is "void *ab initio*." *Whelton*, 432 F.3d at 156, n. 2.

Likewise, the subsequent discharge order is also void. "A discharge obtained in this manner [by declaration], *i.e.*, 'without filing an adversary proceeding to establish undue hardship,' is plainly 'contrary to the express language of the Bankruptcy Code and Rules.' Thus, it is properly treated as 'void.'" *Whelton*, 432 F.3d at 154, quoting *In re Hanson* (internal citations omitted).

Finally, giving finality to a confirmation order premised upon a discharge-by-declaration puts two statutes in needless conflict and renders one of them partially ineffective. Specifically, applying 11 U.S.C. § 1327(a) to give finality to such a confirmation order conflicts with 11 U.S.C. § 1328(a)(2), which provides for discharge of all debts upon completion of the debtor's plan, except, *inter alia*, student loans. As stated in *Mersmann*, "[g]iving preclusive effect to a discharge-by-declaration through § 1327(a) renders part of § 1328(a)(2) nugatory." 505 F.3d at 1048. Because discharge-by-declaration violates the Code, the statutes must be harmonized by allowing § 1328(a)(2)'s specific pronouncement to limit § 1327(a)'s broad effect. *Id.*

For these reasons, the Ninth Circuit's decision is incorrect.

B. Discharging student loan debt through mere declaration in a Chapter 13 plan, rather than an adversary proceeding, is void for lack of the prescribed notice to the creditor.

Significant to this case is that, as noted above, an adversary proceeding is commenced by the filing of a complaint. Because a complaint must comply with Federal Rule of Civil Procedure 8(a), it must "show[ ] that the [debtor] is entitled to relief" and demand the relief sought. FED. R. BANKR. P. 7008 (incorporating FED. R. CIV. P. 8). Therefore, a complaint seeking to discharge a student loan debt upon grounds of undue hardship must allege facts satisfying the requisite elements (n. 6, *supra*) and pray for a discharge of the subject student loan debt. Moreover, the complaint must then be served with a summons. *Id.*, R. 7004. Service upon a corporation, such as USA Funds, must be made upon "an officer, a managing or general agent, or to any agent authorized by appointment or by law to receive service of process. . . ." *Id.*, R. 7004(b)(3).

In comparison, to confirm a Chapter 13 plan, notice of a proposed plan need only include a summary of the plan, not the actual plan. *Id.*, R. 3015(d). Furthermore, notice need only be sent by mail to creditors at the addresses provided by the debtor on his or her list of creditors. *Id.*, R. 2002(g)(2).

Accordingly, notice of a proposed plan does not require specific notice of the effect of the plan on each

creditor, and does not require notice to be served on a person of any particular level of responsibility. *In re Mersmann*, 505 F.3d at 1043; *In re Banks*, 299 F.3d at 301. Thus, the notice requirements to initiate an adversary proceeding are more exacting than the notice required for confirmation of a Chapter 13 plan. *In re Mersmann*, 505 F.3d at 1043.

In this case, Espinosa's plan (which made no mention of undue hardship or its requisite elements and was by no measure the functional equivalent of an adversary complaint) was merely mailed to USA Funds at the post office box address at which it received loan payments.[7] Nevertheless, because USA Funds received notice of Espinosa's case, and could have inquired into the effect of the proposed plan and objected to it, the Ninth Circuit held that USA Funds was not denied due process. That conclusion is incorrect. *In re Ruehle*, *supra*; *In re Hanson*, *supra*; *In re Banks*, *supra*.

While a confirmation order is generally binding, 11 U.S.C. § 1327(a), it does not have that effect when it is not preceded by the required notice. As this

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[7] Student loan lenders, like USA Funds, receive "tidal waves of mail." "The quantity 'of notice' that is issued by the bankruptcy system is so overwhelming that it is necessary to have clear rules in order for creditors to know what notices to notice as opposed to the notices that are deafening legal background noise. The Code and the Rules set forth those clear standards and it is up to the courts to ensure that the lines are not blurred." *In re Ruehle*, 412 F.3d at 684.

Court has stated, "[a]n elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Mullane v. Central Hanover Bank & Trust*, 339 U.S. 306, 314 (1950) (citations omitted).

Applying that principal in the bankruptcy context, "[w]here the Bankruptcy Code and Bankruptcy Rules specify the notice required prior to entry of an order, due process generally entitles a party to receive the notice specified before an order binding the party will be afforded preclusive effect." *In re Banks*, 299 F.3d at 302 (citing *Mullane* and others). Alternatively stated, "[e]very person and entity is entitled to the *prescribed* level of notice for the process to be due. . . ." *In re Ruehle*, 412 F.3d at 684-85 (emphasis added). Anything less is "winking at due process, which is the cornerstone of justice." *Id.*, at 684. "In the end, . . . [d]ue process is not to be sliced, diced and disguised with sauce. Due process must be served whole, without garnish." *Id.*, at 685 (internal quotation and citation omitted).

Therefore, "where an adversary proceeding is required to resolve the disputed rights of the parties, the potential defendant has the right to expect that the proper procedures will be followed." *In re Banks*, 299 F.3d at 302 (citation and internal quotation omitted). Likewise stated, "[t]he creditor has a right to assume that he will receive all of the notices

required by statute before his claim is forever barred." *In re Mersmann*, 505 F.3d at 1049 (citation and internal quotation omitted). Accordingly, this Court has said that "even creditors who have knowledge of a reorganization have a right to assume that the statutory 'reasonable notice' will be given them before their claims are forever barred." *City of New York v. New York, New Haven & Hartford R.R.*, 344 U.S. 293, 297 (1953).

In conclusion, "due process entitles creditors to the heightened notice provided by the Bankruptcy Code and Rules, and the dictates of due process trump policy arguments about finality." *In re Hanson*, 397 F.3d at 486, citing *Mullane*. Therefore, the decision of the Ninth Circuit is incorrect.

C. An order confirming a plan providing for discharge of student loan debt without proof of undue hardship in an adversary proceeding, and the subsequent discharge order, are not res judicata.

The confirmation and discharge orders herein, obtained as they were without proof of undue hardship in an adversary proceeding upon proper notice to USA Funds, violate the Bankruptcy Code and Rules and are not deserving of finality and preclusive effect.

Although the Ninth Circuit bases its ruling, in part, on the finality of discharge orders, the Second and Tenth Circuits disagree that such orders are entitled to preclusive effect in cases such as this.

Whelton, *supra*; *In re Mersmann*, *supra*. As explained by the Tenth Circuit in *Mersmann*, bankruptcy court orders premised upon a discharge-by-declaration fail several of the requirements of res judicata:[8]

> First of all, proper notice is the linchpin of a party's "full and fair opportunity to litigate" a claim. Res judicata will not apply where there is inadequate notice. Simply put, the failure to sufficiently apprise a creditor of a pending action which could eliminate the creditor's interest is a "deficiency that would undermine the fundamental fairness of the original proceedings."

505 F.3d at 1049 (citation omitted).

Such is the case here. USA Funds never had "proper notice" of Espinosa's desire to discharge his student loan debt. There was no adversary complaint to attract attention to his objective, and the plan itself was not served in a manner designed to do so. Thus, "the principles of res judicata must yield where the failure to follow the Code and Rules goes to the heart of the creditor's notice of the bankruptcy plan itself." 505 F.3d at 1050.

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[8] Res judicata requires the satisfaction of four elements: (1) the prior suit must have ended with a judgment on the merits; (2) the parties must be identical or in privity; (3) the suit must be based on the same cause of action; and (4) the party must have had a full and fair opportunity to litigate the claim in the prior suit. *E.g.*, *In re Mersmann*, 505 F.3d at 1049.

The Tenth Circuit also ruled that discharge of student loan debt without an adversary proceeding is not a judgment on the merits:

> Discharge-by-declaration also fails the first element of res judicata – whether the claim was "adjudicated on the merits." Res judicata only bars a collateral attack on claims that were "actually litigated and those that were or could have been raised in the first action."
>
> . . . .
>
> In short, if an issue must be raised through an adversary proceeding it will not have a preclusive effect unless it is actually litigated.

505 F.3d at 1050 (footnote omitted).

Others agree that res judicata is no bar to setting aside an illegal discharge of student loan debt. *Whelton, supra*; Kevin J. Driscoll Jr., *Eradicating the "Discharge by Declaration" for Student Loan Debt in Chapter 13*, 2000 U. Ill. L. R. 1311, 1329-31 (2000).

Finally, the original discharge order herein cannot bar USA Funds' attack on the discharge of Espinosa's student loan debt because that order specifically excepted such debt from discharge. Although the bankruptcy court, on remand, ruled that exclusion of Espinosa's student loan debt from the discharge order was a clerical error, the materially amended discharge order does not relate back to operate retroactively. *See Federal Trade Comm'n v.*

Minneapolis-Honeywell Regulator Co., 344 U.S. 206 (1952).

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

FRANCISCO J. ESPINOSA, *Plaintiff-Appellant*, v. UNITED STUDENT AID FUNDS, INC., *Defendant-Appellee*.	No. 06-16421 D.C. No. CV-04-00447-RCC ORDER AMENDING OPINION AND AMENDED OPINION

Appeal from the United States District Court
for the District of Arizona
Raner C. Collins, District Judge, Presiding

Argued and Submitted April 16, 2008
Submission Vacated June 24, 2008
Resubmitted August 29, 2008

San Francisco, California

Filed October 2, 2008
Amended December 10, 2008

Before: Alex Kozinski, Chief Judge,
A. Wallace Tashima and
N. Randy Smith, Circuit Judges.

Opinion by Chief Judge Kozinski

COUNSEL

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Madeleine C. Wanslee, Gust Rosenfeld P.L.C., Phoenix, Arizona, for the defendant-appellee.

ORDER

The opinion filed October 2, 2008 is amended as follows:

Page 14031, Line 32

> After the sentence ending with "persuasive," insert: "Rather, we agree with Judge Lundin that '*Pardee* and *Andersen* stand soundly for the better-reasoned principle that notice of how the Chapter 13 plan affects creditors' rights is all that the Constitution, the Bankruptcy Code and the Bankruptcy Rules require to bind creditors to the provisions of a confirmed plan under § 1327(a).' Keith M. Lundin, *Chapter 13 Bankruptcy* § 229.1 (3d ed. 2000 & Supp. 2004)."

Page 14031, Line 32

> Before the sentence beginning with "Seeing no reason," start a new paragraph and insert: "Funds also relies heavily on *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004). But as Judge Lundin explains,

Hood is at best unhelpful and more likely undermines Funds's argument:

> Admittedly, sovereign immunity, not the preclusive effect of confirmation, was the issue in *Hood;* but the point remains that the Supreme Court recognized in *Hood* that an adversary proceeding initiated by complaint and summons is not a statutory or constitutional prerequisite to adjudication of the discharge of a student loan. Many of the cases taking issue with *Pardee* and *Andersen* declare the contrary view that the discharge of a student loan by any procedure other than adversary proceeding violates due process. This premise is not consistent with *Hood.*

Keith M. Lundin, *Chapter 13 Bankruptcy* § 346.1 (3d ed. 2000 & Supp. 2004)."

Page 14034, Line 4

After the sentence ending with "proof of claim," insert: "Because 'due process does not require actual notice,' *Jones v. Flowers,* 547 U.S. 220, 225 (2006), it follows a fortiori that actual notice satisfies due process. We find the argument that the Constitution requires something *more* than actual notice strained to the point of the bizarre."

Page 14034, Line 4

Start a new paragraph at the sentence beginning with "The notices"

Page 14034, Lines 4-5

Replace "Funds did receive" with "Funds received"

Page 14036 n.6, Lines 25-26

Delete "; *County of Ventura Tax Collector v. Brawders* (*In re Brawders*), 325 B.R. 405, 414 (9th Cir. BAP 2005)"

Page 14037, Lines 26-27

Replace "If the creditor fails to object" with "If the creditor is notified and fails to object"

The petition for rehearing en banc is denied. *See* Fed R. App. P. 35. No further petitions may be filed and all pending motions are denied.

OPINION

KOZINSKI, Chief Judge:

In our earlier opinion in this case, *Espinosa v. United Student Aid Funds, Inc.*, 530 F.3d 895 (9th Cir. 2008), we remanded to the bankruptcy court for a determination under Rule 60(a) whether exclusion of petitioner's student debt from its discharge order was the result of a clerical error. The bankruptcy court confirmed that:

> the inclusion of paragraph 1(c) in the Discharge Order [which exempted student loan

> obligations from the general discharge] was inserted because of a clerical mistake, because it was the clear intent of the Court, as reflected in the Chapter 13 Plan, as approved by the Court, that all student loan-related obligations were to be discharged if the debtor successfully performed and completed the Plan.

Order of August 20, 2008. We thus finally have presented to us the question that the parties briefed and argued: Whether a debtor may obtain discharge of a student loan by including it in a Chapter 13 plan, if the creditor fails to object after notice of the proposed plan.

Facts

Espinosa filed a Chapter 13 petition and proposed plan that provided for repayment of $13,250 in student loans to United Student Aid Funds, Inc. (Funds). Funds was notified and filed a proof of claim in the amount of $17,832.15.[1] The bankruptcy court eventually confirmed the plan, and the Chapter 13 Trustee mailed Funds a notice advising it that "[t]he amount of the claim filed differs from the amount listed for payment in the plan. Your claim will be paid as listed in the plan." The notice also contained the following warning:

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[1] The difference between these two amounts appears to be interest. *See* n.4 *infra*.

> If an interested party wishes to dispute the above stated treatment of the claim, it is the responsibility of the party to address the dispute. *The claim will be treated as indicated above unless the Trustee receives within 30 days from this mailing, a written request for different treatment.* The request should set forth the specific grounds for alternative treatment and should be filed with the Clerk of the Court, with a copy mailed to the Trustee at [address deleted]. [Emphasis added.]

Funds did not object and Espinosa successfully completed the plan. The bankruptcy court then granted him a discharge.

Three years later, Funds began intercepting Espinosa's income tax refunds to satisfy the unpaid portion of the student loan. Espinosa petitioned the bankruptcy court for an order holding Funds in contempt for violating the discharge injunction. *See* 11 U.S.C. § 524(a)(2). Funds cross-moved for relief from the bankruptcy court's order confirming the plan, on the ground that the order had been entered in violation of Funds's rights under the Bankruptcy Code and Rules.

This is the nub of Funds's argument: To initiate bankruptcy proceedings, a Chapter 13 debtor must notify creditors by mail of the deadline for filing objections and the date of the confirmation hearing. Fed. R. Bankr. P. 2002(b). Espinosa did this. However, student loans may not be discharged under Chapter 13 unless the debtor can show "undue hardship," 11

U.S.C. § 523(a)(8), and such a showing can only be made in an adversary proceeding. *See* Fed. R. Bankr. P. 7001(6). To initiate an adversary, the debtor must file a complaint, *id.* 7003, which must be served on the student loan creditor along with a summons, *id.* 7004. Espinosa didn't do this. Instead Espinosa simply listed the student debt in his Chapter 13 plan, which the bankruptcy court confirmed. Espinosa then made the payments specified in the plan, and the bankruptcy court eventually entered a discharge order. Funds based its motion for relief from this order on Espinosa's failure to initiate an adversary and his consequent failure to obtain a judicial determination of undue hardship.

The bankruptcy court rejected Funds's argument. It held that Funds had violated the discharge injunction and ordered Funds to cease all collection activity against Espinosa. It also denied Funds's motion for relief from the confirmed plan, holding that the plan became final when it was confirmed and that Funds should have objected to any procedural defect before confirmation. Funds appealed to the district court, which reversed. According to the district court, Funds was denied due process because it wasn't served with a complaint and summons. Espinosa appeals.

Analysis

Funds makes both a statutory and a constitutional argument for setting aside the confirmed bankruptcy plan. These arguments turn on the fact

that Espinosa didn't obtain a judicial determination of undue hardship.

[1] **1.** *Statutory Argument.* Funds argues that the bankruptcy court should have set aside Espinosa's discharge because Espinosa didn't comply with the additional procedures required by the Bankruptcy Code and Rules to discharge student debt. *Great Lakes Higher Educ. Corp. v. Pardee (In re Pardee)*, 193 F.3d 1083, 1086 (9th Cir. 1999), which is on all fours with our case, forecloses this argument. As here, the student loan debtor in *Pardee* didn't employ these additional procedures, and the creditor there didn't file any objections to the proposed Chapter 13 plan, which provided that the student loan debt would be discharged. *Id.* at 1084. The bankruptcy court confirmed the plan, and eventually discharged the student loan debt. *Id.* The creditor subsequently argued that the confirmed plan wasn't final under 11 U.S.C. § 1327(a), because the creditor wasn't given the benefit of the additional procedures applicable to the discharge of student loans. *Pardee*, 193 F.3d at 1086. We firmly rejected this argument, following the Tenth Circuit's lead in *Andersen v. UNIPAC-NEBHELP (In re Andersen)*, 179 F.3d 1253 (10th Cir. 1999). In essence, *Pardee* held that a discharge is a final judgment and cannot be set aside or ignored because a party suddenly claims, years later, that the trial court committed an error.

Two circuits have disagreed with *Pardee*, and accepted Funds's statutory argument. *See Educ.*

Credit Mgmt. Corp. v. Mersmann (*In re Mersmann*), 505 F.3d 1033, 1047-49 (10th Cir. 2007) (en banc) (overruling *Andersen*); *Whelton v. Educ. Credit Mgmt. Corp.*, 432 F.3d 150, 154 (2d Cir. 2005). These opinions divine some sort of conflict between the Bankruptcy Code's finality provision, 11 U.S.C. § 1327(a), and those provisions of the Code and Rules that call for an adversary proceeding before a student loan debt may be discharged. We see no such conflict; both provisions can operate fully, within their proper spheres.

The provision giving student loan creditors a right to special procedures comes into play when the case is pending before the bankruptcy court. If a debtor proposes to discharge a student loan debt without invoking the special procedures applicable to such debts, the creditor can object to the plan until the debtor shows undue hardship in an adversary proceeding.

But there are many reasons a student loan creditor might not object to such a Chapter 13 plan. The creditor might, for example, believe that the debtor would be able to make a convincing showing of undue hardship, and thus see no point in wasting the debtor's money, and its own, litigating the issue. Or, the creditor may decide that a Chapter 13 plan presents its best chance of collecting most of the debt, rather than spending years trying to squeeze blood out of a turnip. Or, the creditor may hope that the debtor will make some payments on the plan but

ultimately fail to complete it, in which case the creditor will have collected a portion of the debt and still be free to collect the rest later.[2] Or, the creditor may overlook the notice or fail to understand its legal implications.

[2] Regardless, when the creditor is served with notice of the proposed plan, it has a full and fair opportunity to insist on the special procedures available to student loan creditors by objecting to the plan on the ground that there has been no undue hardship finding. Rights may, of course, be waived or forfeited, if not raised in a timely fashion. This doesn't mean that these rights are ignored, or that a judgment that is entered after a party fails to assert them conflicts with the statutory scheme or is somehow invalid.

[3] The Bankruptcy Code's finality provision comes into play much later in the process, after the

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[2] This is not an idle hope; an estimated two-thirds of Chapter 13 plans ultimately fail. Scott F. Norberg & Andrew J. Velky, *Debtor Discharge and Creditor Repayment in Chapter 13*, 39 Creighton L. Rev. 473, 509 n.74 (2006) ("[D]ata . . . show a continuation of the [Chapter 13 plan] failure rate at about two-thirds.") (citing Lynn M. LoPucki, *Common Sense Consumer Bankruptcy*, 71 Am. Bankr. L.J. 461, 474-75 (1997)); National Bankruptcy Review Commission, *Bankruptcy: The Next Twenty Years* 233 (1997), *available at* http://govinfo.library.unt.edu/nbrc/report/08consum.pdf ("For more than a decade, two-thirds of all Chapter 13 plans have failed before the debtor completes payments, and sometimes before unsecured creditors have received anything at all.").

bankruptcy proceedings come to an end. A bankruptcy discharge order is a final judgment and, even without the special protection of section 1327(a), a final judgment cannot be ignored or set aside just because it was the result of an error. Errors committed during the course of litigation must be corrected by way of a timely appeal. We have therefore "recognized the finality of confirmation orders even if the confirmed bankruptcy plan contains illegal provisions." *Pardee,* 193 F.3d at 1086 (citing *Trulis v. Barton,* 107 F.3d 685 (9th Cir. 1995), *Lawrence Tractor Co. v. Gregory* (*In re Gregory*), 705 F.2d 1118 (9th Cir. 1983), and numerous other cases from across the country). Were the rule otherwise, no judgment would ever be conclusive, as a party aggrieved by it could endlessly re-litigate errors supposedly committed by the trial court.

[4] After a judgment (including a discharge) is finalized, and the time for appeal has run, the judgment can only be reconsidered in the limited circumstances provided by Rule 60(b). *Mersmann* and *Whelton* pay scant attention to 60(b) or the caselaw thereunder, which strictly cabins the circumstances under which a judgment can be reopened after it becomes final. *See, e.g., Gaydos v. Guidant Corp.* (*In re Guidant Corp. Implantable Defibrillators Products Liability Litig.*), 496 F.3d 863, 866 (8th Cir. 2007) ("Rule 60(b) authorizes relief in only the most exceptional of cases."); *United States v. Hartwell,* 448 F.3d 707, 722 (4th Cir. 2004) ("[W]hen deciding whether an

order is 'void' under . . . Rule 60(b)(4) for lack of subject matter jurisdiction, courts must look for the rare instance of a clear usurpation of power."); *Kramer v. Gates*, 481 F.3d 788, 792 (D.C. Cir. 2007) ("Rule 60(b)(6) should be only sparingly used and may not be employed simply to rescue a litigant from strategic choices that later turn out to be improvident.") (internal quotation marks omitted). Instead, both circuits elide the requirements of 60(b) by treating this as a question of res judicata. *Whelton*, 432 F.3d at 155; *Mersmann*, 505 F.3d at 1049-50.[3]

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[3] *Mersmann* also has what it calls a statutory argument, 505 F.3d at 1047-49, but this passage in the opinion proves nothing more than that the order confirming the plan and the subsequent discharge probably were erroneous and might have been successfully appealed. The court doesn't explain what difference this makes when dealing with a judgment that long ago became final. Even an incorrect judgment is binding, unless and until it is re-opened and modified. This portion of the *Mersmann* opinion thus carries no independent force because it proves something that is both obvious and beside the point.

Whelton appears to have been misled by a stray remark in one of our opinions, *Enewally v. Washington Mutual Bank (In re Enewally)*, 368 F.3d 1165, 1173 (9th Cir. 2004), to the effect that "the confirmed plan has no preclusive effect on issues that must be brought by an adversary proceeding." This statement was correct in the circumstances presented in *Enewally*, where "the bankruptcy court specifically reserved the question at issue [during plan confirmation] because it had been raised via an adversary proceeding." *Id.* It is true, of course, that a plan can have no preclusive effect on matters that have been specifically reserved for resolution by way of an ongoing adversary proceeding. We had no occasion in *Enewally* to consider the situation where there is no adversary and the case is resolved entirely by

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[5] This analysis is wrong on two counts. First, what we have here is not a question of res judicata – giving the judgment in the bankruptcy case preclusive effect in another case. The debtor here – like those in *Mersmann* and *Whelton* – sought to reopen the original case in order to enforce the discharge injunction, which came into force by operation of law upon entry of the discharge. A discharge injunction does not operate by way of res judicata; it is, rather, an equitable remedy precluding the creditor, on pain of contempt, from taking *any* actions to enforce the discharged debt. *See* 2 Collier Bankruptcy Manual (3d rev. ed.) ¶ 524.02[2][c] ("Civil contempt is the normal sanction for violations of the discharge injunction.") (footnote omitted); *id.* ¶ 524.02[2] (discharge "provides for a broad injunction against not only legal proceedings, but also any other acts to collect a discharged debt as a personal liability of the debtor"). This includes garnishments, attachments, self-help and all other means of collection – not merely the filing of another lawsuit. 11 U.S.C. § 524(a)(2); 2 Collier Bankruptcy Manual (3d rev. ed.) ¶ 524.02[2]. A discharge judgment could also have res judicata effect, if the creditor were to try to enforce the debt by bringing a post-discharge lawsuit, but the discharge injunction prevents him from even commencing the

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confirmation of the plan. Anything *Enewally* has to say as to matters not presented in that case is, in any event, dicta and thus not binding on us. Reading *Enewally* broadly to speak to that hypothetical situation would also bring it into conflict with *Pardee*, which addresses precisely this issue.

second suit where the res judicata issue could be litigated. There was no second lawsuit in our case, nor (insofar as we can tell) in *Mersmann* and *Whelton*. Res judicata thus has no application to a case like ours, or those considered by the Second and Tenth Circuits.

Even if res judicata *were* the relevant doctrine, neither *Mersmann* nor *Whelton* offer any persuasive reasons why the discharge order here should be denied full preclusive effect. Both cases seem to go off on the theory that the student loan debt couldn't be discharged by the Chapter 13 plan because the creditor was not served with a complaint and summons, as required for the commencement of an adversary proceeding. *Whelton,* 432 F.3d at 155; *Mersmann,* 505 F.2d at 1049-50. But the creditor in our case (as in those other cases) did get proper notice of the proposed Chapter 13 plan, and so knew perfectly well that if the plan were approved and satisfied, the debtor would be granted a discharge of the student debt listed in the plan.[4] Had the creditor wanted to

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[4] In our case, the creditor was served with the "Notice of Commencement of Case Under Chapter 13 of the Bankruptcy Code, Meeting of Creditors, and Fixing of Dates." Attached to this notice was a copy of the proposed Chapter 13 plan, which carried the following prominent warning: "WARNING IF YOU ARE A CREDITOR YOUR RIGHTS MAY BE IMPAIRED BY THIS PLAN." There follows a detailed description of debtor's assets and liabilities, a payment schedule and a great deal of other pertinent information. One section of the plan is titled "Education Loan(s)" and lists all of Funds's loans, for a total of

(Continued on following page)

insist on an adversary, it could have objected to the Chapter 13 plan on the ground that there was no judicial finding of undue hardship. Had Funds so objected, the bankruptcy court would have been required to disapprove the plan and Espinosa would have been put to the hard choice of commencing an adversary or abandoning Chapter 13. But Funds didn't object to the plan and didn't appeal the order

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$13,250. The plan specifies that this amount should be paid in full, followed by a paragraph stating as follows:

> The amounts claimed by the United Student Loan Aid Funds, Inc., *et. al.* for capitalized interest, penalties, and fees shall not be paid for the reasons that the same are penalties and not provided for in the loan agreement between the Debtor and the lender.

The subsequent paragraph provides as follows: "Any amounts or claims for student loans unpaid by this Plan shall be discharged." Paragraph 6 of the plan is titled "OBJECTIONS" and provides as follows: "Objections, by any creditor, must be filed seven (7) days prior to the hearing on Confirmation of Plan along with a copy to the Trustee and Debtor's counsel." Paragraph 7 is titled "PROOF OF CLAIM" and states as follows:

> As a creditor you must file your proof of claim in order to get paid the amounts provided for in this plan. If you do not file your proof of claim by the deadline date you will not receive anything even if the Plan provides for payment. The deadline for filing proofs of claim is set forth in the Notice Of Commencement [Of] Case Under Chapter 13 Of The Bankruptcy Code, Meeting of Creditors, And Fixing of Dates which you have received from the Clerk of the United States Bankruptcy Court.

As noted, Funds filed a proof of claim, but no objection to the plan.

confirming the plan, as it well could have. *See In re Gregory,* 705 F.2d at 1121. Instead, it accepted the payments made by the debtor during the plan's life and then acted as if the whole thing never happened. *See* p. 1198 *supra.*

It makes a mockery of the English language and common sense to say that Funds wasn't given notice, or was somehow ambushed or taken advantage of. The only thing the creditor was not told is that it could insist on an adversary proceeding and a judicial determination of undue hardship. But that's less a matter of notice and more of a tutorial as to what rights the creditor has under the Bankruptcy Code – a long-form *Miranda* warning for bankers. If that were the standard for adequate notice, every notification under the Bankruptcy Code would have to be accompanied by Collier's Treatise, lest the creditor overlook some rights it might have under the Code.

Mersmann recognizes this problem when it states (without citation) that this kind of notice is somehow different from ordinary notices because it "goes to the heart of the creditor's notice of the bankruptcy plan itself." 505 F.3d at 1050. But it's not clear why letting the creditor know, in plain terms, that its rights will be impaired by the proposed plan – and then leaving it up to the creditor and his lawyers to figure out what objections or remedies are available – doesn't satisfy the Tenth Circuit's "heart of the . . . notice" standard. After all, we aren't talking here about destitute widows and orphans, or people who don't speak

English or can't afford a lawyer. The creditors in such cases are huge enterprises whose business it is to administer the very kinds of debts here in question. If this kind of notice to sophisticated parties who have ample resources to protect their rights is inadequate for purposes of res judicata, then the concept of notice has no meaning and res judicata is a fairy tale.

While we are bound by *Pardee,* we have taken a close look at the contrary holdings of our sister circuits in order to determine whether we have strayed off course, in which case we would call for rehearing en banc to correct our caselaw. But we don't find the reasoning of the two other circuits persuasive. Rather, we agree with Judge Lundin that "*Pardee* and *Andersen* stand soundly for the better-reasoned principle that notice of how the Chapter 13 plan affects creditors' rights is all that the Constitution, the Bankruptcy Code and the Bankruptcy Rules require to bind creditors to the provisions of a confirmed plan under § 1327(a)." Keith M. Lundin, *Chapter 13 Bankruptcy* § 229.1 (3d ed. 2000 & Supp. 2004).

Funds also relies heavily on *Tennessee Student Assistance Corp. v. Hood,* 541 U.S. 440 (2004). But as Judge Lundin explains, *Hood* is at best unhelpful and more likely undermines Funds's argument:

> Admittedly, sovereign immunity, not the preclusive effect of confirmation, was the issue in *Hood;* but the point remains that the Supreme Court recognized in *Hood* that an

> adversary proceeding initiated by complaint and summons is not a statutory or constitutional prerequisite to adjudication of the discharge of a student loan. Many of the cases taking issue with *Pardee* and *Andersen* declare the contrary view that the discharge of a student loan by any procedure other than adversary proceeding violates due process. This premise is not consistent with *Hood*.

Keith M. Lundin, *Chapter 13 Bankruptcy* § 346.1 (3d ed. 2000 & Supp. 2004). Seeing no reason to change course, we continue to follow *Pardee*.

2. Funds also argues that the discharge order is void because Funds was denied due process, as it was never served with a complaint and summons as required by Fed. R. Bankr. P. 7004. Three circuits have held, like the district court below, that a student loan debtor's failure to commence an adversary proceeding by serving the student loan creditor with a complaint and summons, denies the creditor due process. *Ruehle v. Educ. Credit Mgmt. Corp.* (*In re Ruehle*), 412 F.3d 679, 682-83 (6th Cir. 2005); *In re Hanson*, 397 F.3d 482, 486 (7th Cir. 2005); *Banks v. Sallie Mae Servicing Corp.* (*In re Banks*), 299 F.3d 296, 302-03 (4th Cir. 2002). Because we did not consider this argument in *Pardee* or any other case, circuit law does not preclude us from addressing it.

We begin our analysis with Rule 60(b), the gateway for setting aside any final judgment. Because the judgment is more than a year old, the first three

subsections of 60(b) cannot be relied on, Fed. R. Civ. P. 60(c)(1), and are inapplicable in any event. Subsection 5, dealing with satisfied judgments, is similarly inapplicable. Subsections 4 and 6, however, are possibilities: If the opposing party is given no notice at all of the lawsuit, or notice is so inadequate as to violate due process, any judgment entered against that party would be void (subsection 4), and such constitutionally deficient service would certainly be a just reason for relief from the judgment (subsection 6). *See, e.g., Owens-Corning Fiberglas Corp. v. Ctr. Wholesale, Inc.* (*In re Ctr. Wholesale, Inc.*), 759 F.2d 1440, 1448-51 (9th Cir. 1985); *Baldwin v. Credit Based Asset Servicing and Securitization,* 516 F.3d 734, 737-38 (8th Cir. 2008).

[6] The standard for what amounts to constitutionally adequate notice, however, is fairly low; it's "notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objection." *Mullane v. Cent. Hanover Bank & Trust Co.,* 339 U.S. 306, 314 (1950). *In re Gregory* rejected an argument that Chapter 13 notice of a proposed plan is constitutionally defective because it does not apprise each creditor of how its own claim will be disposed of by the plan:

> When the holder of a large, unsecured claim such as Lawrence receives any notice from the bankruptcy court that its debtor has initiated bankruptcy proceedings, *it is under*

> *constructive or inquiry notice that its claim may be affected, and it ignores the proceedings to which the notice refers at its peril.* "Whatever is notice enough to excite attention and put the party on his guard and call for inquiry, is notice of everything to which such inquiry may have led. When a person has sufficient information to lead him to a fact, he shall be deemed to be conversant of it." *D.C. Transit System, Inc. v. United States,* 531 F.Supp. 808, 812 (D.D.C. 1982). (citations omitted.) The notice included the names of the bankruptcy judge, the trustee, and Gregory's attorney, and presumably any of them could have helped Lawrence obtain a copy of the plan or informed it as to the plan's proposal concerning its claim. If Lawrence had made any inquiry following receipt of the notice, it would have discovered that it needed to act to protect its interest.

705 F.2d at 1123 (emphasis added).

[7] The reasoning of *In re Gregory* is controlling here, not only because it is law of the circuit, but because it's entirely consistent with *Mullane* and the more than a half century of due process caselaw that follows it. If a party is adequately notified of a pending lawsuit, it is deemed to know the consequences of responding or failing to respond, even if gaining actual knowledge requires inquiry into court files, hiring a lawyer or conducting legal research. Indeed, it would be virtually impossible to operate a legal system if due process required more notice than that.

[8] As noted, Funds here did receive actual notice of Espinosa's bankruptcy case; we know this both from documents in the record, which show receipt, and from the fact that Funds presented a proof of claim. Because "due process does not require actual notice," *Jones v. Flowers,* 547 U.S. 220, 225 (2006), it follows a fortiori that actual notice satisfies due process. We find the argument that the Constitution requires something *more* than actual notice strained to the point of the bizarre.

The notices Funds received also warned of the consequences of failing to object – which is more than due process requires. A creditor receiving such notice would have known that its debt could be adversely affected by the proposed plan, and that it needed to file an objection if it wished to avoid that result.[5] Funds raised no such objection, nor did it appeal the order confirming the plan. We cannot say that Funds was taken by surprise or was denied due process. Quite the contrary: Funds appears to have been a willing participant, perfectly happy to receive the benefits of the Chapter 13 plan, but unwilling to

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[5] Even after the bankruptcy court confirmed the plan, Funds had an opportunity to dispute it. The notice attached to the proposed plan specifically advised that the "amount of the claim [Funds] filed differs from the amount listed for payment in [Espinosa's] plan," and warned Funds that its "claim will be paid as listed in the plan" unless the Chapter 13 Trustee received notice within 30 days from Funds that it "wishes to dispute the above stated treatment of the claim." Funds did not object.

suffer the consequences of its failure to file an objection.

The three circuits that have held that the creditor is denied due process in circumstances such as these appear to have a different understanding of what due process requires. As best we can follow their reasoning, it is that a creditor who is entitled to heightened notice by statute is also entitled to such heightened notice as a matter of due process. This footnote from *In re Banks,* the first circuit case to adopt this novel approach, tries to explain this rationale: "We do not today hold that the Constitution in itself requires a summons and service of process to discharge student loan debt. We merely confirm that where the Bankruptcy Code and Rules require a heightened degree of notice, due process entitles a party to receive such notice before an order binding the party will be afforded preclusive effect." 299 F.3d at 303 n.4. *Accord In re Hanson,* 397 F.3d at 486 ("student loan creditors justifiably rely on the explicit notice provisions of the Bankruptcy Code and Rules and have no reason to act until the service of a summons for an adversary proceeding apprises them that their property rights may be affected."); *In re Ruehle,* 412 F.3d at 683. The Seventh Circuit in *Hanson* goes so far as to say that "Hanson's failure to serve [the creditor] with a summons and an adversary proceeding complaint effectively denied [the creditor] the opportunity of presenting an objection prior to the

adjudication of its rights." 397 F.3d at 486 (citing *Mullane*, 339 U.S. at 313-14).

We do not find this reasoning persuasive and thus have no occasion to call for rehearing en banc to consider overruling *In re Gregory*. To begin with, we find it both wrong and dangerous to hold that the standard for what amounts to constitutionally adequate notice can be changed by legislation. The constitutional standard, as we understand it, requires that a party affected by the litigation obtain sufficient notice so that it is able to take steps to defend its interests. Congress can, of course, give rights to additional notice, but we find it difficult to see how this can affect the floor provided by due process – either to increase or diminish it.

[9] Even if Congress could affect the constitutional standard, it didn't do so here: Congress made it quite clear that a creditor need only get ordinary notice of a Chapter 13 plan to be bound by its terms. That Congress provided heightened notice requirements for an adversary proceeding, which didn't take place here, is of no consequence. Had there been an adversary proceeding, and had the creditor not been served with a complaint and summons, the creditor may then have been free to ignore the adversary until it was properly served. But here (and in the similar cases from other courts) there was no adversary proceeding; the creditor's rights were cut off by the Chapter 13 plan, precisely as specified in the notice

the creditor did receive. We reject the idea that a creditor who is in the business of administering student loans has a *constitutional* right to ignore a properly served notice that clearly specifies that its debt will be discharged on successful completion of the plan.[6]

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[6] Our Bankruptcy Appellate Panel's opinion in *In re Repp* suffers from the same defect in reasoning. The opinion there bemoans "an unfair Catch-22" and even a "double Catch-22" that the student loan creditor supposedly confronts. *Educ. Credit Mgmt. Corp. v. Repp* (*In re Repp*), 307 B.R. 144, 153 (9th Cir. BAP 2004). We don't see any Catch-22: A creditor who wants to force the debtor to follow the statutory procedure for discharging student debt need only object to the proposed plan on the ground that there has not been a proper undue hardship finding. The debtor must then procure such a finding by bringing an adversary proceeding and serving the creditor with a complaint and summons. As Judge Ryan points out in his well-reasoned dissent, the creditor in *Repp* (like the one in our case) was not subjected to any kind of unfairness:

> It should be pointed out that ECMC was a creditor, had filed a claim, and knew or should have known that its rights could be affected by the plan. It cannot stick its head in the sand, ignore the plan terms, and later claim foul play because it is adversely impacted by the plan. Due process does not place substance over form. Here, the substance is that ECMC had actual knowledge of the plan terms and chose to default. It cannot now seek a second bite of the apple by way of a due process argument.

Id. at 156. The *Repp* majority would have done well to adopt the view of its dissenting colleague and follow circuit law as announced by *Pardee* and *In re Gregory*. *In re Repp* and cases following it are overruled. *See, e.g., Sallie Mae Servicing Corp. v. Ransom* (*In re Ransom*), 336 B.R. 790, 797-98 (9th Cir. BAP 2005).

In short, we find the due process argument even less persuasive than the statutory argument, despite the eagerness of some of our sister circuits and other courts to adopt it. What appears to be going on is that courts are re-casting what may be a simple statutory violation as a denial of due process so that they can set aside judgments with which they're unhappy. This approach is not consistent with the theory of objective judging, which calls for us to apply the law fairly to the facts and let the chips fall where they ~~may~~. We see no reason to reconsider the approach we adopted in *In re Gregory,* which we believe is fully consistent with the Supreme Court's teachings in *Mullane,* and with fairness and justice as well.

Conclusion

It is apparent that a number of courts in our circuit, including the district court below, are uncomfortable with the practice of some Chapter 13 debtors to seek to discharge their student debts by working them into their Chapter 13 plans. Some bankruptcy judges have announced that they won't confirm plans that seek to discharge student loan debts without an adversary proceeding, even when the creditor fails to object to the plan. *See, e.g., Patton v. U.S. Dep't of Educ. (In re Patton),* 261 B.R. 44, 48 (Bankr. E.D. Wash. 2001); *In re Webber,* 251 B.R. 554, 557-58 (Bankr. D. Ariz. 2000). In fact, one of these opinions has suggested that inclusion of a "non-dischargeable"

debt in a Chapter 13 plan "may be the subject of sanctions." *In re Patton,* 261 B.R. at 48.

[10] For reasons explained above, we view matters quite differently. Our long-standing circuit law holds that student loan debts can be discharged by way of a Chapter 13 plan if the creditor does not object, after receiving notice of the proposed plan, *Pardee,* 193 F.3d at 1086, and that such notice is not constitutionally inadequate. *In re Gregory,* 705 F.2d at 1123. We find it highly unlikely that a creditor whose business it is to administer student loans will be misled by the customary bankruptcy procedures or somehow be bamboozled into giving up its rights by crafty student debtors. If the creditor is notified and fails to object, it is doubtless the result of a careful calculation that this course is the one most likely to yield repayment of at least a portion of the debt. In such circumstances, bankruptcy courts have no business standing in the way. Cases such as *In re Webber* and *In re Patton* are, to that extent, overruled.

[11] The district court's judgment reversing the bankruptcy court is reversed. The case is remanded to the bankruptcy court for reinstatement of the order enforcing the discharge injunction and for a determination whether the creditor acted willfully in violating the injunction under the standard we announced

in *ZiLOG, Inc. v. Corning (In Re ZiLOG, Inc.)*, 450 F.3d 996 (9th Cir. 2006).[7]

REVERSED and REMANDED.

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[7] As we held in *Zilog*:

> A party who knowingly violates the discharge injunction can be held in contempt under section 105(a) of the bankruptcy code. *See In re Bennett*, 298 F.3d at 1069; *Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502, 507 (9th Cir. 2002) (holding that civil contempt is an appropriate remedy for a willful violation of section 524's discharge injunction). In *Bennett*, we noted that the party seeking contempt sanctions has the burden of proving, by clear and convincing evidence, that the sanctions are justified. We cited with approval the standard adopted by the Eleventh Circuit for violation of the discharge injunction: "[T]he movant must prove that the creditor (1) knew the discharge injunction was applicable and (2) intended the actions which violated the injunction."

450 F.3d at 1007 (citing *Renwick v. Bennett (In re Bennett)*, 298 F.3d 1059, 1069 (9th Cir. 2002) (citing *Hardy v. United States (In re Hardy)*, 97 F.3d 1384, 1390 (11th Cir. 1996)). That the creditor may have believed that the discharge was inappropriately entered, or that it could be set aside under Rule 60(b), is of no consequence. A creditor is not free to violate the discharge injunction because it has doubts as to the validity of the discharge. If the creditor believes the discharge is defective, it may petition the bankruptcy court to reopen and set aside the judgment under Rule 60(b), but it may not commence collection proceedings unless and until the court grants such relief. If the bankruptcy court finds that the creditor here willfully violated the injunction, it shall, at the very least, impose sanctions to the extent necessary to make Espinosa whole. *See* 2 Collier Bankruptcy Manual (3d rev. ed.) ¶ 524.02[2][c] ("In cases in which the discharge injunction was violated willfully, courts have awarded debtors actual damages, punitive damages and attorney's fees.") (footnote omitted).

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

FRANCISCO J. ESPINOSA, *Plaintiff-Appellant*, v. UNITED STUDENT AID FUNDS, INC., *Defendant-Appellee*.	No. 06-16421 D.C. No. CV-04-00447-RCC OPINION

Appeal from the United States District Court
for the District of Arizona
Raner C. Collins, District Judge, Presiding

Argued and Submitted April 16, 2008
Submission Vacated June 24, 2008
Resubmitted August 29, 2008
San Francisco, California

Filed October 2, 2008

Before: Alex Kozinski, Chief Judge,
A. Wallace Tashima and
N. Randy Smith, Circuit Judges.

Opinion by Chief Judge Kozinski

COUNSEL

Michael J. Meehan, Munger Chadwick, Tucson, Arizona; James L. Robinson, Jr., Robinson & Rylander, P.C., Tucson, Arizona, for the plaintiff-appellant.

Madeleine C. Wanslee, Gust Rosenfeld P.L.C., Phoenix, Arizona, for the defendant-appellee.

OPINION

KOZINSKI, Chief Judge:

In our earlier opinion in this case, *Espinosa v. United Student Aid Funds, Inc.*, 530 F.3d 895 (9th Cir. 2008), we remanded to the bankruptcy court for a determination under Rule 60(a) whether exclusion of petitioner's student debt from its discharge order was the result of a clerical error. The bankruptcy court confirmed that:

> the inclusion of paragraph 1(c) in the Discharge Order [which exempted student loan obligations from the general discharge] was inserted because of a clerical mistake, because it was the clear intent of the Court, as reflected in the Chapter 13 Plan, as approved by the Court, that all student loan-related obligations were to be discharged if the debtor successfully performed and completed the Plan.

Order of August 20, 2008. We thus finally have presented to us the question that the parties briefed and argued: Whether a debtor may obtain discharge of a student loan by including it in a Chapter 13 plan, if the creditor fails to object after notice of the proposed plan.

Facts

Espinosa filed a Chapter 13 petition and proposed plan that provided for repayment of $13,250 in student loans to United Student Aid Funds, Inc. (Funds). Funds was notified and filed a proof of claim in the amount of $17,832.15.[1] The bankruptcy court eventually confirmed the plan, and the Chapter 13 Trustee mailed Funds a notice advising it that "[t]he amount of the claim filed differs from the amount listed for payment in the plan. Your claim will be paid as listed in the plan." The notice also contained the following warning:

> If an interested party wishes to dispute the above stated treatment of the claim, it is the responsibility of the party to address the dispute. *The claim will be treated as indicated above unless the Trustee receives within 30 days from this mailing, a written request for different treatment.* The request should set forth the specific grounds for alternative treatment and should be filed with the Clerk of the Court, with a copy mailed to the Trustee at [address deleted]. [Emphasis added.]

Funds did not object and Espinosa successfully completed the plan. The bankruptcy court then granted him a discharge.

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[1] The difference between these two amounts appears to be interest. *See* n.4 *infra*.

Three years later, Funds began intercepting Espinosa's income tax refunds to satisfy the unpaid portion of the student loan. Espinosa petitioned the bankruptcy court for an order holding Funds in contempt for violating the discharge injunction. *See* 11 U.S.C. § 524(a)(2). Funds cross-moved for relief from the bankruptcy court's order confirming the plan, on the ground that the order had been entered in violation of Funds's rights under the Bankruptcy Code and Rules.

This is the nub of Funds's argument: To initiate bankruptcy proceedings, a Chapter 13 debtor must notify creditors by mail of the deadline for filing objections and the date of the confirmation hearing. Fed. R. Bankr. P. 2002(b). Espinosa did this. However, student loans may not be discharged under Chapter 13 unless the debtor can show "undue hardship," 11 U.S.C. § 523(a)(8), and such a showing can only be made in an adversary proceeding. *See* Fed. R. Bankr. P. 7001(6). To initiate an adversary, the debtor must file a complaint, *id.* 7003, which must be served on the student loan creditor along with a summons, *id.* 7004. Espinosa didn't do this. Instead Espinosa simply listed the student debt in his Chapter 13 plan, which the bankruptcy court confirmed. Espinosa then made the payments specified in the plan, and the bankruptcy court eventually entered a discharge order. Funds based its motion for relief from this order on Espinosa's failure to initiate an adversary and his consequent failure to obtain a judicial determination of undue hardship.

The bankruptcy court rejected Funds's argument. It held that Funds had violated the discharge injunction and ordered Funds to cease all collection activity against Espinosa. It also denied Funds's motion for relief from the confirmed plan, holding that the plan became final when it was confirmed and that Funds should have objected to any procedural defect before confirmation. Funds appealed to the district court, which reversed. According to the district court, Funds was denied due process because it wasn't served with a complaint and summons. Espinosa appeals.

Analysis

Funds makes both a statutory and a constitutional argument for setting aside the confirmed bankruptcy plan. These arguments turn on the fact that Espinosa didn't obtain a judicial determination of undue hardship.

[1] **1.** *Statutory Argument.* Funds argues that the bankruptcy court should have set aside Espinosa's discharge because Espinosa didn't comply with the additional procedures required by the Bankruptcy Code and Rules to discharge student debt. *Great Lakes Higher Educ. Corp. v. Pardee (In re Pardee)*, 193 F.3d 1083, 1086 (9th Cir. 1999), which is on all fours with our case, forecloses this argument. As here, the student loan debtor in *Pardee* didn't employ these additional procedures, and the creditor there didn't file any objections to the proposed Chapter 13 plan, which provided that the student loan debt would be

discharged. *Id.* at 1084. The bankruptcy court confirmed the plan, and eventually discharged the student loan debt. *Id.* The creditor subsequently argued that the confirmed plan wasn't final under 11 U.S.C. § 1327(a), because the creditor wasn't given the benefit of the additional procedures applicable to the discharge of student loans. *Pardee,* 193 F.3d at 1086. We firmly rejected this argument, following the Tenth Circuit's lead in *Andersen v. UNIPAC-NEBHELP* (*In re Andersen*), 179 F.3d 1253 (10th Cir. 1999). In essence, *Pardee* held that a discharge is a final judgment and cannot be set aside or ignored because a party suddenly claims, years later, that the trial court committed an error.

Two circuits have disagreed with *Pardee,* and accepted Funds's statutory argument. *See Educ. Credit Mgmt. Corp. v. Mersmann* (*In re Mersmann*), 505 F.3d 1033, 1047-49 (10th Cir. 2007) (en banc) (overruling *Andersen*); *Whelton v. Educ. Credit Mgmt. Corp.,* 432 F.3d 150, 154 (2d Cir. 2005). These opinions divine some sort of conflict between the Bankruptcy Code's finality provision, 11 U.S.C. § 1327(a), and those provisions of the Code and Rules that call for an adversary proceeding before a student loan debt may be discharged. We see no such conflict; both provisions can operate fully, within their proper spheres.

The provision giving student loan creditors a right to special procedures comes into play when the case is pending before the bankruptcy court. If a debtor proposes to discharge a student loan debt

without invoking the special procedures applicable to such debts, the creditor can object to the plan until the debtor shows undue hardship in an adversary proceeding.

But there are many reasons a student loan creditor might not object to such a Chapter 13 plan. The creditor might, for example, believe that the debtor would be able to make a convincing showing of undue hardship, and thus see no point in wasting the debtor's money, and its own, litigating the issue. Or, the creditor may decide that a Chapter 13 plan presents its best chance of collecting most of the debt, rather than spending years trying to squeeze blood out of a turnip. Or, the creditor may hope that the debtor will make some payments on the plan but ultimately fail to complete it, in which case the creditor will have collected a portion of the debt and still be free to collect the rest later.[2] Or, the creditor may

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[2] This is not an idle hope; an estimated two-thirds of Chapter 13 plans ultimately fail. Scott F. Norberg & Andrew J. Velky, *Debtor Discharge and Creditor Repayment in Chapter 13*, 39 Creighton L. Rev. 473, 509 n.74 (2006) ("[D]ata . . . show a continuation of the [Chapter 13 plan] failure rate at about two-thirds.") (citing Lynn M. LoPucki, *Common Sense Consumer Bankruptcy*, 71 Am. Bankr. L.J. 461, 474-75 (1997)); National Bankruptcy Review Commission, *Bankruptcy: The Next Twenty Years* 233 (1997), *available at* http://govinfo.library.unt.edu/nbrc/report/08consum.pdf ("For more than a decade, two-thirds of all Chapter 13 plans have failed before the debtor completes payments, and sometimes before unsecured creditors have received anything at all.").

overlook the notice or fail to understand its legal implications.

[2] Regardless, when the creditor is served with notice of the proposed plan, it has a full and fair opportunity to insist on the special procedures available to student loan creditors by objecting to the plan on the ground that there has been no undue hardship finding. Rights may, of course, be waived or forfeited, if not raised in a timely fashion. This doesn't mean that these rights are ignored, or that a judgment that is entered after a party fails to assert them conflicts with the statutory scheme or is somehow invalid.

[3] The Bankruptcy Code's finality provision comes into play much later in the process, after the bankruptcy proceedings come to an end. A bankruptcy discharge order is a final judgment and, even without the special protection of section 1327(a), a final judgment cannot be ignored or set aside just because it was the result of an error. Errors committed during the course of litigation must be corrected by way of a timely appeal. We have therefore "recognized the finality of confirmation orders even if the confirmed bankruptcy plan contains illegal provisions." *Pardee,* 193 F.3d at 1086 (citing *Trulis v. Barton,* 107 F.3d 685 (9th Cir. 1995), *Lawrence Tractor Co. v. Gregory* (*In re Gregory*), 705 F.2d 1118 (9th Cir. 1983), and numerous other cases from across the country). Were the rule otherwise, no judgment would ever be conclusive, as a party aggrieved by it could endlessly re-litigate errors supposedly committed by the trial court.

[4] After a judgment (including a discharge) is finalized, and the time for appeal has run, the judgment can only be reconsidered in the limited circumstances provided by Rule 60(b). *Mersmann* and *Whelton* pay scant attention to 60(b) or the caselaw thereunder, which strictly cabins the circumstances under which a judgment can be reopened after it becomes final. *See, e.g., Gaydos v. Guidant Corp.* (*In re Guidant Corp. Implantable Defibrillators Products Liability Litig.*), 496 F.3d 863, 866 (8th Cir. 2007) ("Rule 60(b) authorizes relief in only the most exceptional of cases."); *United States v. Hartwell,* 448 F.3d 707, 722 (4th Cir. 2004) ("[W]hen deciding whether an order is 'void' under . . . Rule 60(b)(4) for lack of subject matter jurisdiction, courts must look for the rare instance of a clear usurpation of power."); *Kramer v. Gates,* 481 F.3d 788, 792 (D.C. Cir. 2007) ("Rule 60(b)(6) should be only sparingly used and may not be employed simply to rescue a litigant from strategic choices that later turn out to be improvident.") (internal quotation marks omitted). Instead, both circuits elide the requirements of 60(b) by treating this as a question of res judicata. *Whelton,* 432 F.3d at 155; *Mersmann,* 505 F.3d at 1049-50.[3]

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[3] *Mersmann* also has what it calls a statutory argument, 505 F.3d at 1047-49, but this passage in the opinion proves nothing more than that the order confirming the plan and the subsequent discharge probably were erroneous and might have been successfully appealed. The court doesn't explain what difference this makes when dealing with a judgment that long ago became final. Even an incorrect judgment is binding, unless

(Continued on following page)

[5] This analysis is wrong on two counts. First, what we have here is not a question of res judicata – giving the judgment in the bankruptcy case preclusive effect in another case. The debtor here – like those in *Mersmann* and *Whelton* – sought to reopen the original case in order to enforce the discharge injunction, which came into force by operation of law upon entry of the discharge. A discharge injunction does not operate by way of res judicata; it is, rather, an equitable remedy precluding the creditor, on pain of contempt, from taking *any* actions to enforce the discharged debt. *See* 2 Collier Bankruptcy Manual (3d rev. ed.) ¶ 524.02[2][c] ("Civil contempt is the

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and until it is re-opened and modified. This portion of the *Mersmann* opinion thus carries no independent force because it proves something that is both obvious and beside the point.

Whelton appears to have been misled by a stray remark in one of our opinions, *Enewally v. Washington Mutual Bank (In re Enewally)*, 368 F.3d 1165, 1173 (9th Cir. 2004), to the effect that "the confirmed plan has no preclusive effect on issues that must be brought by an adversary proceeding." This statement was correct in the circumstances presented in *Enewally*, where "the bankruptcy court specifically reserved the question at issue [during plan confirmation] because it had been raised via an adversary proceeding." *Id.* It is true, of course, that a plan can have no preclusive effect on matters that have been specifically reserved for resolution by way of an ongoing adversary proceeding. We had no occasion in *Enewally* to consider the situation where there is no adversary and the case is resolved entirely by confirmation of the plan. Anything *Enewally* has to say as to matters not presented in that case is, in any event, dicta and thus not binding on us. Reading *Enewally* broadly to speak to that hypothetical situation would also bring it into conflict with *Pardee*, which addresses precisely this issue.

normal sanction for violations of the discharge injunction.") (footnote omitted); *id.* ¶ 524.02[2] (discharge "provides for a broad injunction against not only legal proceedings, but also any other acts to collect a discharged debt as a personal liability of the debtor"). This includes garnishments, attachments, self-help and all other means of collection – not merely the filing of another lawsuit. 11 U.S.C. § 524(a)(2); 2 Collier Bankruptcy Manual (3d rev. ed.) ¶ 524.02[2]. A discharge judgment could also have res judicata effect, if the creditor were to try to enforce the debt by bringing a post-discharge lawsuit, but the discharge injunction prevents him from even commencing the second suit where the res judicata issue could be litigated. There was no second lawsuit in our case, nor (insofar as we can tell) in *Mersmann* and *Whelton*. Res judicata thus has no application to a case like ours, or those considered by the Second and Tenth Circuits.

Even if res judicata *were* the relevant doctrine, neither *Mersmann* nor *Whelton* offer any persuasive reasons why the discharge order here should be denied full preclusive effect. Both cases seem to go off on the theory that the student loan debt couldn't be discharged by the Chapter 13 plan because the creditor was not served with a complaint and summons, as required for the commencement of an adversary proceeding. *Whelton*, 432 F.3d at 155; *Mersmann*, 505 F.2d at 1049-50. But the creditor in our case (as in those other cases) did get proper notice of the proposed Chapter 13 plan, and so knew perfectly well

that if the plan were approved and satisfied, the debtor would be granted a discharge of the student debt listed in the plan.[4] Had the creditor wanted to

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[4] In our case, the creditor was served with the "Notice of Commencement of Case Under Chapter 13 of the Bankruptcy Code, Meeting of Creditors, and Fixing of Dates." Attached to this notice was a copy of the proposed Chapter 13 plan, which carried the following prominent warning: "WARNING IF YOU ARE A CREDITOR YOUR RIGHTS MAY BE IMPAIRED BY THIS PLAN." There follows a detailed description of debtor's assets and liabilities, a payment schedule and a great deal of other pertinent information. One section of the plan is titled "Education Loan(s)" and lists all of Funds's loans, for a total of $13,250. The plan specifies that this amount should be paid in full, followed by a paragraph stating as follows:

> The amounts claimed by the United Student Loan Aid Funds, Inc., *et. al.* for capitalized interest, penalties, and fees shall not be paid for the reasons that the same are penalties and not provided for in the loan agreement between the Debtor and the lender.

The subsequent paragraph provides as follows: "Any amounts or claims for student loans unpaid by this Plan shall be discharged." Paragraph 6 of the plan is titled "OBJECTIONS" and provides as follows: "Objections, by any creditor, must be filed seven (7) days prior to the hearing on Confirmation of Plan along with a copy to the Trustee and Debtor's counsel." Paragraph 7 is titled "PROOF OF CLAIM" and states as follows:

> As a creditor you must file your proof of claim in order to get paid the amounts provided for in this plan. If you do not file your proof of claim by the deadline date you will not receive anything even if the Plan provides for payment. The deadline for f'ing proofs of claim is set forth in the Notice Of Commencement [Of] Case Under Chapter 13 Of The Bankruptcy Code, Meeting of Creditors, And Fixing of Dates which you have received from the Clerk of the United States Bankruptcy Court.

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insist on an adversary, it could have objected to the Chapter 13 plan on the ground that there was no judicial finding of undue hardship. Had Funds so objected, the bankruptcy court would have been required to disapprove the plan and Espinosa would have been put to the hard choice of commencing an adversary or abandoning Chapter 13. But Funds didn't object to the plan and didn't appeal the order confirming the plan, as it well could have. *See In re Gregory,* 705 F.2d at 1121. Instead, it accepted the payments made by the debtor during the plan's life and then acted as if the whole thing never happened. *See* p. 1198 *supra.*

It makes a mockery of the English language and common sense to say that Funds wasn't given notice, or was somehow ambushed or taken advantage of. The only thing the creditor was not told is that it could insist on an adversary proceeding and a judicial determination of undue hardship. But that's less a matter of notice and more of a tutorial as to what rights the creditor has under the Bankruptcy Code – a long-form *Miranda* warning for bankers. If that were the standard for adequate notice, every notification under the Bankruptcy Code would have to be accompanied by Collier's Treatise, lest the creditor overlook some rights it might have under the Code.

As noted, Funds filed a proof of claim, but no objection to the plan.

Mersmann recognizes this problem when it states (without citation) that this kind of notice is somehow different from ordinary notices because it "goes to the heart of the creditor's notice of the bankruptcy plan itself." 505 F.3d at 1050. But it's not clear why letting the creditor know, in plain terms, that its rights will be impaired by the proposed plan – and then leaving it up to the creditor and his lawyers to figure out what objections or remedies are available – doesn't satisfy the Tenth Circuit's "heart of the . . . notice" standard. After all, we aren't talking here about destitute widows and orphans, or people who don't speak English or can't afford a lawyer. The creditors in such cases are huge enterprises whose business it is to administer the very kinds of debts here in question. If this kind of notice to sophisticated parties who have ample resources to protect their rights is inadequate for purposes of res judicata, then the concept of notice has no meaning and res judicata is a fairy tale.

While we are bound by *Pardee,* we have taken a close look at the contrary holdings of our sister circuits in order to determine whether we have strayed off course, in which case we would call for rehearing en banc to correct our caselaw. But we don't find the reasoning of the two other circuits persuasive. Seeing no reason to change course, we continue to follow *Pardee.*

2. Funds also argues that the discharge order is void because Funds was denied due process, as it was never served with a complaint and summons as

required by Fed. R. Bankr. P. 7004. Three circuits have held, like the district court below, that a student loan debtor's failure to commence an adversary proceeding by serving the student loan creditor with a complaint and summons, denies the creditor due process. *Ruehle v. Educ. Credit Mgmt. Corp.* (*In re Ruehle*), 412 F.3d 679, 682-83 (6th Cir. 2005); *In re Hanson,* 397 F.3d 482, 486 (7th Cir. 2005); *Banks v. Sallie Mae Servicing Corp.* (*In re Banks*), 299 F.3d 296, 302-03 (4th Cir. 2002). Because we did not consider this argument in *Pardee* or any other case, circuit law does not preclude us from addressing it.

We begin our analysis with Rule 60(b), the gateway for setting aside any final judgment. Because the judgment is more than a year old, the first three subsections of 60(b) cannot be relied on, Fed. R. Civ. P. 60(c)(1), and are inapplicable in any event. Subsection 5, dealing with satisfied judgments, is similarly inapplicable. Subsections 4 and 6, however, are possibilities: If the opposing party is given no notice at all of the lawsuit, or notice is so inadequate as to violate due process, any judgment entered against that party would be void (subsection 4), and such constitutionally deficient service would certainly be a just reason for relief from the judgment (subsection 6). *See, e.g., Owens-Corning Fiberglas Corp. v. Ctr. Wholesale, Inc.* (*In re Ctr. Wholesale, Inc.*), 759 F.2d 1440, 1448-51 (9th Cir. 1985); *Baldwin v. Credit Based Asset Servicing and Securitization,* 516 F.3d 734, 737-38 (8th Cir. 2008).

[6] The standard for what amounts to constitutionally adequate notice, however, is fairly low; it's "notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objection." *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950). *In re Gregory* rejected an argument that Chapter 13 notice of a proposed plan is constitutionally defective because it does not apprise each creditor of how its own claim will be disposed of by the plan:

> When the holder of a large, unsecured claim such as Lawrence receives any notice from the bankruptcy court that its debtor has initiated bankruptcy proceedings, *it is under constructive or inquiry notice that its claim may be affected, and it ignores the proceedings to which the notice refers at its peril.* "Whatever is notice enough to excite attention and put the party on his guard and call for inquiry, is notice of everything to which such inquiry may have led. When a person has sufficient information to lead him to a fact, he shall be deemed to be conversant of it." *D.C. Transit System, Inc. v. United States*, 531 F.Supp. 808, 812 (D.D.C. 1982). (citations omitted.) The notice included the names of the bankruptcy judge, the trustee, and Gregory's attorney, and presumably any of them could have helped Lawrence obtain a copy of the plan or informed it as to the plan's proposal concerning its claim. If Lawrence had made any inquiry following receipt

> of the notice, it would have discovered that it needed to act to protect its interest.

705 F.2d at 1123 (emphasis added).

[7] The reasoning of *In re Gregory* is controlling here, not only because it is law of the circuit, but because it's entirely consistent with *Mullane* and the more than a half century of due process caselaw that follows it. If a party is adequately notified of a pending lawsuit, it is deemed to know the consequences of responding or failing to respond, even if gaining actual knowledge requires inquiry into court files, hiring a lawyer or conducting legal research. Indeed, it would be virtually impossible to operate a legal system if due process required more notice than that.

[8] As noted, Funds here did receive actual notice of Espinosa's bankruptcy case; we know this both from documents in the record, which show receipt, and from the fact that Funds presented a proof of claim. The notices Funds did receive also warned of the consequences of failing to object – which is more than due process requires. A creditor receiving such notice would have known that its debt could be adversely affected by the proposed plan, and that it needed to file an objection if it wished to avoid that result.[5] Funds raised no such objection, nor did it

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[5] Even after the bankruptcy court confirmed the plan, Funds had an opportunity to dispute it. The notice attached to the proposed plan specifically advised that the "amount of the claim [Funds] filed differs from the amount listed for payment in [Espinosa's] plan," and warned Funds that its "claim will be paid

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appeal the order confirming the plan. We cannot say that Funds was taken by surprise or was denied due process. Quite the contrary: Funds appears to have been a willing participant, perfectly happy to receive the benefits of the Chapter 13 plan, but unwilling to suffer the consequences of its failure to file an objection.

The three circuits that have held that the creditor is denied due process in circumstances such as these appear to have a different understanding of what due process requires. As best we can follow their reasoning, it is that a creditor who is entitled to heightened notice by statute is also entitled to such heightened notice as a matter of due process. This footnote from *In re Banks,* the first circuit case to adopt this novel approach, tries to explain this rationale: "We do not today hold that the Constitution in itself requires a summons and service of process to discharge student loan debt. We merely confirm that where the Bankruptcy Code and Rules require a heightened degree of notice, due process entitles a party to receive such notice before an order binding the party will be afforded preclusive effect." 299 F.3d at 303 n.4. *Accord In re Hanson,* 397 F.3d at 486 ("student loan creditors justifiably rely on the explicit notice provisions of the Bankruptcy Code and Rules and have no reason to act until the service of a summons for an adversary proceeding apprises them that their property rights may

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as listed in the plan" unless the Chapter 13 Trustee received notice within 30 days from Funds that it "wishes to dispute the above stated treatment of the claim." Funds did not object.

be affected."); *In re Ruehle,* 412 F.3d at 683. The Seventh Circuit in *Hanson* goes so far as to say that "Hanson's failure to serve [the creditor] with a summons and an adversary proceeding complaint effectively denied [the creditor] the opportunity of presenting an objection prior to the adjudication of its rights." 397 F.3d at 486 (citing *Mullane,* 339 U.S. at 313-14).

We do not find this reasoning persuasive and thus have no occasion to call for rehearing en banc to consider overruling *In re Gregory.* To begin with, we find it both wrong and dangerous to hold that the standard for what amounts to constitutionally adequate notice can be changed by legislation. The constitutional standard, as we understand it, requires that a party affected by the litigation obtain sufficient notice so that it is able to take steps to defend its interests. Congress can, of course, give rights to additional notice, but we find it difficult to see how this can affect the floor provided by due process – either to increase or diminish it.

[9] Even if Congress could affect the constitutional standard, it didn't do so here: Congress made it quite clear that a creditor need only get ordinary notice of a Chapter 13 plan to be bound by its terms. That Congress provided heightened notice requirements for an adversary proceeding, which didn't take place here, is of no consequence. Had there been an adversary proceeding, and had the creditor not been served with a complaint and summons, the creditor may then have been free to ignore the adversary until

it was properly served. But here (and in the similar cases from other courts) there was no adversary proceeding; the creditor's rights were cut off by the Chapter 13 plan, precisely as specified in the notice the creditor did receive. We reject the idea that a creditor who is in the business of administering student loans has a *constitutional* right to ignore a properly served notice that clearly specifies that its debt will be discharged on successful completion of the plan.[6]

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[6] Our Bankruptcy Appellate Panel's opinion in *In re Repp* suffers from the same defect in reasoning. The opinion there bemoans "an unfair Catch-22" and even a "double Catch-22" that the student loan creditor supposedly confronts. *Educ. Credit Mgmt. Corp. v. Repp* (*In re Repp*), 307 B.R. 144, 153 (9th Cir. BAP 2004). We don't see any Catch-22: A creditor who wants to force the debtor to follow the statutory procedure for discharging student debt need only object to the proposed plan on the ground that there has not been a proper undue hardship finding. The debtor must then procure such a finding by bringing an adversary proceeding and serving the creditor with a complaint and summons. As Judge Ryan points out in his well-reasoned dissent, the creditor in *Repp* (like the one in our case) was not subjected to any kind of unfairness:

> It should be pointed out that ECMC was a creditor, had filed a claim, and knew or should have known that its rights could be affected by the plan. It cannot stick its head in the sand, ignore the plan terms, and later claim foul play because it is adversely impacted by the plan. Due process does not place substance over form. Here, the substance is that ECMC had actual knowledge of the plan terms and chose to default. It cannot now seek a second bite of the apple by way of a due process argument.

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In short, we find the due process argument even less persuasive than the statutory argument, despite the eagerness of some of our sister circuits and other courts to adopt it. What appears to be going on is that courts are re-casting what may be a simple statutory violation as a denial of due process so that they can set aside judgments with which they're unhappy. This approach is not consistent with the theory of objective judging, which calls for us to apply the law fairly to the facts and let the chips fall where they may. We see no reason to reconsider the approach we adopted in *In re Gregory,* which we believe is fully consistent with the Supreme Court's teachings in *Mullane,* and with fairness and justice as well.

Conclusion

It is apparent that a number of courts in our circuit, including the district court below, are uncomfortable with the practice of some Chapter 13 debtors to seek to discharge their student debts by working them into their Chapter 13 plans. Some bankruptcy judges have announced that they won't confirm plans that seek to discharge student loan debts without an adversary proceeding, even when the creditor fails to

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Id. at 156. The *Repp* majority would have done well to adopt the view of its dissenting colleague and follow circuit law as announced by *Pardee* and *In re Gregory*. *In re Repp* and cases following it are overruled. *See, e.g., Sallie Mae Servicing Corp. v. Ransom (In re Ransom)*, 336 B.R. 790, 797-98 (9th Cir. BAP 2005).

object to the plan. *See, e.g., Patton v. U.S. Dep't of Educ. (In re Patton)*, 261 B.R. 44, 48 (Bankr. E.D. Wash. 2001); *In re Webber*, 251 B.R. 554, 557-58 (Bankr. D. Ariz. 2000). In fact, one of these opinions has suggested that inclusion of a "non-dischargeable" debt in a Chapter 13 plan "may be the subject of sanctions." *In re Patton*, 261 B.R. at 48.

[10] For reasons explained above, we view matters quite differently. Our long-standing circuit law holds that student loan debts can be discharged by way of a Chapter 13 plan if the creditor does not object, after receiving notice of the proposed plan, *Pardee*, 193 F.3d at 1086, and that such notice is not constitutionally inadequate. *In re Gregory*, 705 F.2d at 1123. We find it highly unlikely that a creditor whose business it is to administer student loans will be misled by the customary bankruptcy procedures or somehow be bamboozled into giving up its rights by crafty student debtors. If the creditor fails to object, it is doubtless the result of a careful calculation that this course is the one most likely to yield repayment of at least a portion of the debt. In such circumstances, bankruptcy courts have no business standing in the way. Cases such as *In re Webber* and *In re Patton* are, to that extent, overruled.

[11] The district court's judgment reversing the bankruptcy court is reversed. The case is remanded to the bankruptcy court for reinstatement of the order enforcing the discharge injunction and for a determination whether the creditor acted willfully in violating the injunction under the standard we announced

in *ZiLOG, Inc. v. Corning (In Re ZiLOG, Inc.)*, 450 F.3d 996 (9th Cir. 2006).[7]

REVERSED and REMANDED.

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[7] As we held in *Zilog*:

> A party who knowingly violates the discharge injunction can be held in contempt under section 105(a) of the bankruptcy code. *See In re Bennett*, 298 F.3d at 1069; *Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502, 507 (9th Cir. 2002) (holding that civil contempt is an appropriate remedy for a willful violation of section 524's discharge injunction). In *Bennett*, we noted that the party seeking contempt sanctions has the burden of proving, by clear and convincing evidence, that the sanctions are justified. We cited with approval the standard adopted by the Eleventh Circuit for violation of the discharge injunction: "[T]he movant must prove that the creditor (1) knew the discharge injunction was applicable and (2) intended the actions which violated the injunction."

450 F.3d at 1007 (citing *Renwick v. Bennett (In re Bennett)*, 298 F.3d 1059, 1069 (9th Cir. 2002) (citing *Hardy v. United States (In re Hardy)*, 97 F.3d 1384, 1390 (11th Cir. 1996)). That the creditor may have believed that the discharge was inappropriately entered, or that it could be set aside under Rule 60(b), is of no consequence. A creditor is not free to violate the discharge injunction because it has doubts as to the validity of the discharge. If the creditor believes the discharge is defective, it may petition the bankruptcy court to reopen and set aside the judgment under Rule 60(b), but it may not commence collection proceedings unless and until the court grants such relief. If the bankruptcy court finds that the creditor here willfully violated the injunction, it shall, at the very least, impose sanctions to the extent necessary to make Espinosa whole. *See* 2 Collier Bankruptcy Manual (3d rev. ed.) ¶ 524.02[2][c] ("In cases in which the discharge injunction was violated willfully, courts have awarded debtors actual damages, punitive damages and attorney's fees.") (footnote omitted).

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FRANCISCO J. ESPINOSA, *Plaintiff-Appellant*, v. UNITED STUDENT AID FUNDS, INC., *Defendant-Appellee.*	No. 06-16421 D.C. No. CV-04-00447-RCC OPINION

Appeal from the United States District Court
for the District of Arizona
Raner C. Collins, District Judge, Presiding

Argued and Submitted
April 16, 2008 – San Francisco, California

Filed June 24, 2008

Before: Alex Kozinski, Chief Judge,
A. Wallace Tashima and
N. Randy Smith, Circuit Judges.

Per Curiam Opinion

COUNSEL

Michael J. Meehan, Munger Chadwick, Tucson, Arizona; James L. Robinson, Jr., Robinson & Rylander, P.C., Tucson, Arizona, for the plaintiff-appellant.

Madeleine C. Wanslee, Gust Rosenfeld P.L.C., Phoenix, Arizona, for the defendant-appellee.

OPINION

PER CURIAM:

Espinosa obtained $13,250.00 in student loans from United Student Aid Funds, Inc. (Funds). He later filed a Chapter 13 bankruptcy petition and plan. The plan provided that he repay the $13,250.00 principal, and that accrued capitalized interest, penalties and fees be discharged. The clerk of the bankruptcy court mailed a notice of commencement and a copy of the proposed plan to Funds, which gave Funds the usual notice of the date and time of the plan confirmation hearing and the deadline for filing objections to the plan. Funds then filed a proof of claim for $17,832.15, which presumably included unpaid accrued capitalized interest, penalties and fees. But Funds filed no objections to the plan, and as there were no other creditors, the bankruptcy court confirmed the plan as proposed. Espinosa subsequently paid Funds $13,250.00 over the course of four years, at which point the plan was completed and the bankruptcy court issued a discharge order, filed May 30, 1997. Curiously, the discharge order provided that Espinosa was "discharged from all debts provided for by the plan . . . except any debt . . . for a student loan," which contradicted the terms of the plan and pretty much rendered the whole exercise pointless from Espinosa's point of view. Curiouser still, Espinosa did not seek reconsideration of the discharge order, nor did he appeal.

Three years after the discharge order was filed, Funds began "offsetting" or "intercept[ing]" Espinosa's income tax refunds to satisfy the unpaid portion of the student loan. (The parties don't explain what they mean by "offsetting" and "intercept[ing]," but we assume they mean that Funds somehow got ahold of Espinosa's income tax refund check, and kept the money for itself.) Espinosa petitioned the bankruptcy court for an order holding Funds in contempt for violating the discharge injunction. *See* 11 U.S.C. § 524(a)(2). Funds cross-moved for relief from the bankruptcy court's order confirming the plan, on the ground that the order had been entered in violation of Funds's rights under the Bankruptcy Code and Rules, and the Due Process Clause.

This is the nub of Funds's argument: To satisfy its obligations under the Bankruptcy Code, a Chapter 13 debtor usually only has to notify creditors by mail of the deadline for filing objections and when the confirmation hearing will occur, Fed. R. Bankr. P. 2002(b), as Espinosa did here. However, student loans may be discharged under Chapter 13, 11 U.S.C. § 1328(a)(2), only if the debtor can show "undue hardship," *id.* § 523(a)(8), and such a showing can only be made in an adversary proceeding, Fed. R. Bankr. P. 7001(6). To initiate an adversary proceeding, a debtor must file a complaint, *id.* 7003, which must be served on the creditor along with a summons, *id.* 7004. Espinosa didn't commence an adversary proceeding and therefore did not obtain a judicial declaration of "undue hardship." Absent such

a declaration, Funds argues, the bankruptcy court lacked authority to discharge the student loan debt by means of the Chapter 13 plan. Funds's motion for relief from the discharge order was based on the fact that Espinosa obtained his discharge without following the statutorily-prescribed procedures for discharging student loan debt.

The bankruptcy court held that Funds violated the discharge injunction and ordered Funds to cease all collection activities against Espinosa. The court also denied Funds's motion for relief from the confirmed plan, holding that the plan became final when it was confirmed and that Funds should have objected to any procedural defect before confirmation. Funds appealed to the district court, which reversed. According to the district court, the order confirming the plan is void because Funds received insufficient notice and was thus denied due process. Espinosa appeals.

Funds argues that the confirmed bankruptcy plan is void, because Funds didn't receive service of a complaint and summons and there was no adversary proceeding to establish "undue hardship," which the Bankruptcy Code and Rules require as a condition for discharging a student loan debt. We rejected this argument in *Great Lakes Higher Educ. Corp.* v. *Pardee* (*In re Pardee*), 193 F.3d 1083, 1086 (9th Cir. 1999). Like Funds, the creditor in *Pardee* received notice of the debtor's proposed Chapter 13 plan, which provided for discharge of the student loan debt without the benefit of an adversary proceeding or an undue hardship finding. *Id.* at 1084. The creditor did

not object, the bankruptcy court confirmed the Chapter 13 plan and the student loan debt was eventually discharged. *Id.* Years later, the creditor argued that the confirmed plan wasn't final under 11 U.S.C. § 1327(a), because the debtor had failed to follow the proper procedures for obtaining a student loan discharge. *Pardee*, 193 F.3d at 1086. We pointed out in *Pardee* that the creditor there, like Funds here, had timely notice of the Chapter 13 plan and failed to object. We held that the creditor "should have raised this argument [about the absence of an adversary proceeding and a finding of undue hardship] in the bankruptcy court by objecting to the plan prior to its confirmation, or by appealing the bankruptcy court's confirmation of the plan. It failed to do either." *Id.*

Relying on the Tenth Circuit's opinion in *Andersen* v. *UNIPAC-NEBHELP* (*In re Andersen*), 179 F.3d 1253, 1258 (10th Cir. 1999), *overruled by Educ. Credit Mgmt. Corp.* v. *Mersmann* (*In re Mersmann*), 505 F.3d 1033, 1046-47 (10th Cir. 2007) (en banc), we held that "[i]f a creditor fails to protect its interests by timely objecting to a plan or appealing the confirmation order, 'it cannot later complain about a certain provision contained in a confirmed plan, even if such a provision is inconsistent with the Code.'" *Pardee*, 193 F.3d at 1086. In reaching this conclusion, *Pardee* also relied on a long line of cases, from our circuit and elsewhere, that "recognized the finality of confirmation orders even if the confirmed bankruptcy plan contains illegal provisions." *Id.*; *see, e.g.*, *Andersen*, 179 F.3d at 1258; *In re Szostek*, 886 F.2d 1405, 1409-10 (3d

Cir. 1989); *Republic Supply Co.* v. *Shoaf,* 815 F.2d 1046, 1049-50 (5th Cir. 1987); *Lawrence Tractor Co.* v. *Gregory* (*In re Gregory*), 705 F.2d 1118, 1121 (9th Cir. 1983); *Ground Sys., Inc.* v. *Albert* (*In re Ground Sys., Inc.*), 213 B.R. 1016, 1020 (B.A.P. 9th Cir. 1997); *In re Walker,* 128 B.R. 465, 468 (Bankr. D. Idaho 1991).

Since *Pardee,* there have been significant developments in this area of the law: Two other circuits have rejected *Pardee*'s reasoning – significantly including the Tenth Circuit, which overruled its own *Andersen* opinion, on which *Pardee* principally relied. *Mersmann,* 505 F.3d at 1046-47; *Whelton* v. *Educ. Credit Mgmt. Corp.,* 432 F.3d 150, 154 (2d Cir. 2005). Our own Bankruptcy Appellate Panel has questioned the reasoning of *Pardee,* albeit by a divided vote. *Educ. Credit Mgmt. Corp.* v. *Repp* (*In re Repp*), 307 B.R. 144, 148 n.3 (B.A.P. 9th Cir. 2004). And three circuits, as well as our Bankruptcy Appellate Panel, have held that the procedures employed here violate the creditor's due process rights. *Ruehle* v. *Educ. Credit Mgmt. Corp.* (*In re Ruehle*), 412 F.3d 679, 684 (6th Cir. 2005); *In re Hanson,* 397 F.3d 482, 486 (7th Cir. 2005); *Banks* v. *Sallie Mae Servicing Corp.* (*In re Banks*), 299 F.3d 296, 302 (4th Cir. 2002); *Repp,* 307 B.R. at 154.

It is thus fair to say that our position in *Pardee* is in the minority; indeed, among the circuits we now stand alone. Thus, while we (as a three-judge panel) are bound to follow *Pardee* as controlling circuit law, we must not blind ourselves to developments elsewhere. If we were persuaded that our position is

erroneous, we would have the right, and perhaps even the duty, to bring the matter to the attention of our colleagues and suggest that an en banc court be convened to reconsider the matter afresh.

We have therefore taken a look at the cases from the other circuits and do not immediately find them persuasive; the rationale of *Pardee* and *Andersen,* relying as it does on straightforward notions of notice and waiver, seem far more consistent with accepted principles concerning the finality of judgments that transcend this particular corner of the law. But we have no occasion to resolve this matter because, as previously noted, the discharge order in this case simply did not discharge Espinosa's student loan debt. Indeed, it specifically excluded the student loan debt from the discharge. *See* p.7295 *supra.* This order was, to be sure, inconsistent with Espinosa's Chapter 13 plan's terms; in effect, the bankruptcy court did not make good on its promise to the debtor that, if he satisfied the terms of the plan, it would discharge all of his listed debts.

Whether the bankruptcy court could have been held to that promise, and compelled to issue an order discharging the student debt, is an open question. Espinosa could have tested that proposition by asking the bankruptcy court to modify its order to discharge the student loan debt and, failing that, taken an appeal. But he did not. Rather, he allowed the bankruptcy court's discharge order to become final, and the time to appeal lapsed long ago. Nor did Espinosa seek to reopen the judgment by way of Federal Rule

of Civil Procedure 60. *See* Fed. R. Bankr. P. 9024. Instead, Espinosa sought to enforce the discharge injunction against Funds. The obvious problem, of course, is that the discharge injunction simply does not run against Funds because the bankruptcy court's discharge order did not cover its debt. Funds was thus free to collect its debt, and the bankruptcy court seems to have misread its own order when it held otherwise.

Much the same seems to have happened in *Mersmann,* 505 F.3d at 1039-40 & n.5, where the court found that "the clerk of the bankruptcy court automatically generates the discharge orders and simply failed to tailor it [sic] to the facts of Mersmann's case." In *Mersmann,* the bankruptcy court corrected the discharge orders pursuant to Federal Rule of Civil Procedure 60(a). 505 F.3d at 1040. Here, Espinosa did not seek a correction of the order, and the bankruptcy court did not correct the order sua sponte, as it is permitted to do by Rule 60(a). It is possible that the bankruptcy court was unaware of the precise language of its discharge order, and was under the mis-impression that the order did cover the student loan debt; that seems to be the most plausible inference from its order enforcing the discharge injunction against Funds. And it is possible that neither party brought the precise language of the discharge order to the bankruptcy court's attention, as the parties said barely anything about it in their briefs before us.

We therefore remand the case to the district court, with instructions for it to remand to the bankruptcy court. On remand, the bankruptcy court has our express leave to consider whether its discharge order in this case was entered as a result of a clerical error and, if so, whether to correct it so as to conform to Espinosa's Chapter 13 plan. *See Travelers Cas. and Surety Co.* v. *Pac. Gas and Elec. Co.*, No. 04-15605, 2008 WL 1970961, at *1 (9th Cir. May 8, 2008). The remand shall be for this limited purpose and no other, and shall last the earlier of 60 days or until such time as the bankruptcy court enters an order addressing this issue.

The parties shall notify us within 5 days of the entry of the bankruptcy court's order, and we shall determine at that time whether the case requires further briefing or can be resubmitted on the existing briefs and arguments.

SUBMISSION VACATED; REMANDED FOR A LIMITED PURPOSE.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

FRANCISCO J. ESPINOSA, Appellee, vs. UNITED STUDENT AID FUNDS, INC., Appellant.	No. CV 04-447-TUC-RCC **ORDER**

Pending before the Court are the Opening Brief of Appellant (Motion to Reverse the Bankruptcy Court's Order Denying Appellant's Motion for Relief) (Docket #5), Response Brief of Appellee (Docket #7), Reply Brief of Appellant (Docket #8), and Reply Brief of Appellee (Docket #10).

The Court grants Appellant's Motion to reverse the Bankruptcy Court's order and holds that the Confirmation Order is void. This matter is remanded to Bankruptcy Court for an adversary hearing to determine whether Appellee qualifies under the 11 U.S.C. § 523(a)(8) exception for the discharge of his student loan.

I. Factual and Procedural Background

Between August 1988 and February 1989, Appellee executed four student loan promissory notes for a total principal amount of $13,250.00, with varying

rates of interest accrual. On December 7, 1992, Appellee filed a voluntary petition for relief under Chapter 13 of the United States Bankruptcy Code, along with a Chapter 13 Plan ("Plan") in the Bankruptcy Court for the District of Arizona. Appellee sent a copy of the Plan and notice of a hearing on the Plan to Appellant's post-office box address on December 10, 1992. The notice was not particularly addressed to a managing or general agent authorized to accept service of process, yet complied with Federal Rules of Bankruptcy Procedure 2002(b).[1] The Plan stipulated that Appellee's debt to Appellant was $13,250.00 – the original, principal amount loaned to Appellee. In addition, it contained a provision that called for the discharge of any amounts or claims for student loans not stated in the Plan; however, it did not contain any language indicating that not discharging the loan would impose an "undue hardship" from 11 U.S.C. § 523(a)(8). A Notice of Commencement was included along with the Plan that stated that the confirmation hearing would be held on April 15, 1993.

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[1] This notice complied with Fed. R. Bankr.P. 2002(b), which deals with notice to creditors of debtor's Plan. However, as will be discussed later, because it was not addressed to a managing or general agent, as would be proper in order to discharge a portion of Appellee's debt. Therefore it did not comply with Fed. R. Bankr.P. 7004(b)(3), which deals with notice for adversary proceedings.

Appellant filed a Proof of Claim on January 8, 1993, in the amount of $17,832.15.[2] Appellee did not make an objection to the Proof of Claim, nor was any adversary proceeding filed to determine the dischargeability of the loan, yet the Plan was not altered to reflect the amount set forth in the Proof of Claim. The Chapter 13 Trustee filed an objection to confirmation of the Plan on the grounds that Appellant's classification should be changed from priority claim status to general unsecured claim status. On April 9, 1993, Appellant amended his bankruptcy papers to reflect the change.

A Confirmation Hearing was held on April 15, 1993, and the Confirmation Order was entered for Appellee's Plan on May 6, 1993. The only mention of the student loan debt in the Confirmation Order was the reclassification. The Confirmation Order was not mailed to Appellant; however, the Chapter 13 Trustee filed a "Notice to Creditor" that acknowledged the discrepancy between Appellant's Proof of Claim and the amount in the Plan, yet stated that the amount listed in the Plan is what would be followed. This notice stated that the amount in the Plan would be followed "unless the Trustee receives within 30 days

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[2] When a creditor receives a Chapter 13 Plan, it must submit a "Proof of Claim" form, which verifies the amount debtor owes. Here, when Appellant filed the Proof of Claim, it indicated that the amount owed was $17,832.15. This amount included the principal amount ($13,250.00) plus interest that had accrued from March 1, 1989, at 8.00% adjusted and 10.45% variable rates.

from this mailing, a written request for different treatment." Appellant did not reply.

On May 30, 1997, Appellee received the Chapter 13 Discharge of Debtor statement, having paid the Appellant the amount designated in the Plan.

Appellant's loans were subrogated to the Educational Department pursuant to its reinsurance agreement. The Educational Department commenced collection efforts, including attempts to offset tax refunds, against Appellee in November 2000. In an effort to seek relief from the Education Department's collection attempts, in June 2003, Appellee reopened his bankruptcy case and filed a Motion for Violation of the Discharge Injunction, Contempt, Sanctions and Damages on October 2, 2003. Appellee asserted that all interest and other charges had been discharged pursuant to the Chapter 13 Plan.

On October 30, 2003, Appellant filed a Motion for Relief from Order and Response to Debtor's Motion for Violation of the Discharge Injunction, Contempt, Sanctions and Damages. Appellant then requested a recall of Appellee's loan from the Education Department, which was completed on June 3, 2004. On August 4, 2004, Appellant filed a Supplement to Motion for Relief, and a hearing was held the following day. On August 12, 2004, the Bankruptcy Court denied Appellant's Motion for Relief in its Memorandum Decision, and the following day, a formal order was entered. Appellant filed its Notice of Appeal to this Court.

II. Discussion

A. Jurisdiction

This case arises from a final order entered in the United States Bankruptcy Court for the District of Arizona on August 13, 2004, which had subject-matter jurisdiction based on 28 U.S.C. § 1334(b). Appellant timely filed this Appeal to the United States District Court for the District of Arizona on August 18, 2004, that has appellate jurisdiction under 28 U.S.C. § 158(a)(1).

B. Standard of Review

A bankruptcy court's findings of fact are evaluated under a clearly erroneous standard, while its findings of law are reviewed *de novo. Ragsdale v. Haller,* 780 F.2d 794, 795 (9th Cir. 1986). Due process notice is a mixed question of law and fact; therefore it is to be reviewed by this Court *de novo. Demos v. Brown (In re Graves),* 279 B.R. 266, 270 (B.A.P.9th Cir. 2002); *GMAC Mortgaged Corp. v. Salisbury (In re Loloee),* 241 B.R. 655, 659 (B.A.P.9th Cir.1999); *United Student Aid Funds, Inc. v. Pena (In re Pena),* 207 B.R. 919, 920 (B.A.P.9th Cir.1997).

C. Due Process Notice for the Discharge of Student Loans in Light of *Res Judicata*

When an individual files a Chapter 13 Plan, there is a presumption that education loans are nondischargeable, in accordance with strong Congressional

intent. *In re Rifino,* 245 F.3d 1083 (9th Cir. 2001). This is to preserve the student loan program and "assure future generations of students will also have an educational loan available . . . " 125 CONG. REC. S. 9160 (daily ed. July 11, 1979) (remarks of Sen. DeConcini). Congress expanded 11 U.S.C. § 523(a)(8), which mandates the repayment of educational loans, but allows an exception if the debtor demonstrates an "undue hardship" if required to repay the education loan. In order to qualify for this exception, however, the debtor must initiate an adversary proceeding to prove this "undue hardship." *Tenn. Student Assistance v. Hood, (In re Hood),* 541 U.S. 440, 124 S. Ct. 1905 (2004). If a debtor proceeds to have his education loans discharged under the exception, then under Part VII of the Federal Rules of Bankruptcy Procedure, Rule 7004(a), which is quite similar to the Federal Rules of Civil Procedure Rule 4(c)(1), the debtor must serve the summons and a copy of the complaint to the creditor. Fed. R. Bankr.P. 7004(a), *incorporating* Fed. R.Civ. P. 4(c)(1). Service may be completed by first class mail; however, the rule mandates that service must be directed to an officer, a managing or general agent, or to any other officer authorized to accept service of process. Fed. R. Bankr.P. 7004(b)(3), *incorporating* Fed. R. Civ. P. 4(h)(1).

At the hearing, the court will determine whether the debtor has met his burden to qualify for the Section 523(a)(8) exception, which requires the debtor to show: "(1) inability to maintain, based on current

income and expenses, a minimal standard of living if forced to repay the student loan, (2) additional circumstances indicating that this state of affairs is likely to persist for a considerable period, and (3) good faith efforts to repay the loan." *Educ. Credit Mgmt. Corp. v. Repp (In re Repp),* 307 B.R. 144 (B.A.P. 9th Cir. 2004) *citing United Student Aid Funds, Inc. v. Pena (In re Pena),* 155 F.3d 1108,1111 (9th Cir. 1998).

The question in this case then becomes, if this proper Section 523(a)(8) procedure is not adhered to, and a debtor's Plan, which includes the discharge of a portion of his education loans, is confirmed by a bankruptcy court, then does *res judicata* prevent the creditor from subsequently challenging the validity of the Plan based upon lack of due process notice? In 1999, the Ninth Circuit heard a case that dealt specifically with the *res judicata* issue as it pertains to a creditor failing to make an objection to a Chapter 13 Plan that purportedly discharged student debts without following the Section 523(a)(8) procedure. *Lakes Higher Educ. Corp. v. Pardee (In re Pardee),* 193 F.3d 1083 (9th Cir. 1999). In that case, the Ninth Circuit found that since the creditor "failed to file an objection to the plan . . . [and] clearly failed to take an active role in protecting its own interests[,]" then the principle of finality trumped any rights of the creditor. *Id.* at 1086. Agreeing with how the Tenth Circuit reasoned under a similar fact pattern, the court warned that "[a] creditor cannot simply sit on its rights and expect that the bankruptcy court or trustee will assume the duty of protecting its interests."

Id. citing Andersen v. UNIPAC-NEBHELP (In re Andersen), 179 F.3d 1253, 1257 (10th Cir. 1999). The *In re Pardee* court, however, never addressed the question of whether the creditor had due process notice.

This question remained unanswered until 2004 when the Ninth Circuit addressed the concern of due process as it relates to *res judicata. In re Repp,* 307 B.R. at 144. The *In re Repp* court emphasized, what it characterized as the "cornerstone of modern due process," that "notice must be reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to object." *In re Repp,* 307 B.R. at 149 *citing Mullane v. Central Hanover Bank & Trust Co.,* 339 U.S. 306 (1950). While the court stopped short of overruling *In re Pardee* and held that it still remained good law, the *In re Repp* court severely limited the reach of *In re Pardee.*

The debtor from *In re Repp* included a provision in his Chapter 13 Plan, which was mailed out to the holder of his student loan, that stated that because paying beyond the principal of his student loan would create an "undue hardship," the remainder would be discharged pursuant to Section 523(a)(8). *In re Repp,* 307 B.R. at 148. The court recognized that the student loan discharge provision was "illegal" and should not have been in the plan. *Id.* at 152 *citing In re Webber,* 251 B.R. 554, 557-58 (Bankr.D.Ariz. 2000). Because this provision was illegal, the creditor would rely on the fact that (1) the bankruptcy court would

perform its obligation in ensuring that the Bankruptcy Code and rules of procedure were being followed, and (2) Rule 7001(6) would be complied with, which mandates an adversary hearing to determine whether the debtor was eligible for a Section 523(a)(8) exception to the standard rule. *In re Repp*, 307 B.R. at 152-53. Agreeing with the Fourth and Sixth Circuits, the court held that where due process notice falls below that which Rule 7004 requires to discharge a student loan, then *res judicata* will not prevent the creditor from later asserting its rights to object to the illegal provision.[3] *Id.* at 147.

Like the cases cited above, here, Appellee's Chapter 13 Plan attempted to discharge a portion of his student loan since Appellant's Proof of Claim stated the amount indebted was $17,832.15, while Appellee's Chapter 13 Plan listed the amount as $13,250.00. As the Ninth Circuit stated, because Bankruptcy Code and procedures lay out a specific procedure for discharging education loans (which includes service of process notice of the adversary hearing in order to determine whether the debtor has demonstrated an "undue hardship" as required), then the creditor (Appellant) should be able to place

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[3] *Compare Banks v. Sallie Mae Servicing Corp. (In re Banks)*, 299 F.3d 296, 303 (4th Cir. 2002) (finding that because there was a lack of notice, then the "confirmation and discharge orders discharging the interest are not entitled to preclusive effect.") *and Ruehle v. Educ. Credit Mgmt. Corp. (In re Ruehle)*, 307 B.R. 28, 33-34 (6th Cir. 2004) *with In re Andersen*, 179 F.3d at 1257.

reliance in the bankruptcy court to ensure the proper procedure will be followed. *See In re Repp,* 307 B.R. at 152-53. If debtor wishes to have his debt discharged, then creditor will receive formal service of process, in compliance with Federal Rules of Bankruptcy Procedure 7004.

The facts show that Appellant complied with procedure by submitting its Proof of Claim in the amount of $17,832.15. Since Appellee did not amend the Plan to reflect this, he had attempted to discharge $4,582.15 of his student loan. In accordance with Ninth Circuit precedent set in *In re Repp,* because this student loan was not discharged according to procedure, which would have given Appellant notice "reasonably calculated" to properly object to this discharge, then *res judicata* will not preclude Appellant from now objecting to the Plan.

III. Conclusion

In light of the Ninth Circuit's ruling in *In re Repp,* even though Appellant received notice of the discharge and the Plan was confirmed, because the correct type of notice in order to comply with Rule 7004(b)(3) was not followed, it does not preclude Appellant from challenging the validity of the Plan based on lack of notice. As the Ninth Circuit precedent on the issue stated: "[t]he minimal service requirements for chapter 13 plan confirmations cannot be used as a way to stay below the creditor's radar . . . " *In re Repp,* 307 B.R. at 154.

Therefore, this Court finds that Appellant was denied due process notice and reverses the ruling of the Bankruptcy Court.

Accordingly, IT IS HEREBY ORDERED that the ruling of the Bankruptcy Court is REVERSED, and the case is REMANDED for further proceedings.

DATED this 18th day of July, 2006.

/s/ Raner C. Collins
Raner C. Collins
United States District Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re:	Chapter 13
FRANCISCO J. ESPINOSA, Debtors.	Case No. 4-92-03819-EWH
	MEMORANDUM DECISION
	(Filed Aug. 12, 2004)

INTRODUCTION

Are the terms of a confirmed Chapter 13 Plan that provide for discharge of a student loan debt binding if the debtor failed to follow the requirements of the Bankruptcy Code and Bankruptcy Rules of Procedure for obtaining a hardship discharge of the student loan obligation? I find that the holding of *In re Pardee*, 193 F.3d 1083 (9th Cir. 1999) controls and requires an affirmative answer to the question.

FACTS

The Debtor filed a Chapter 13 Petition ("Petition") and Chapter Plan ("Plan") on December 7, 1992. The Plan which was noticed to all creditors pursuant to Fed. R. Bankr. P. 2002(b), including United States Student Aid Funds ("USA Funds") and the United States Department of Education ("DE") (collectively "Student Loan Creditors"), provided for the payment of $13,250.00 in outstanding student loan debt owed to a number of different student loan

creditors. The Plan provided that "any amounts or claims for student loans unpaid by this Plan shall be discharged." Both the Plan and the 341 notice listed April 15, 1993 as the date of the confirmation hearing. The Plan provided that any objections to the Plan be filed seven (7) days prior to the confirmation hearing.

On January 18, 1993, USA Funds, apparently on behalf of all of the outstanding student loan creditors, filed an unsecured, non-priority claim of $17,832.15. On March 30, 1993, the Chapter 13 Trustee filed an objection to the proposed Plan because the Plan classified the student loan claim as a priority. The Student Loan Creditor did not file a Plan objection. On April 25, 1993, a confirmation hearing was held. There were no objections to the confirmation of the Plan, other than that of the Trustee, which was resolved pursuant to a stipulated order ("Confirmation Order") entered on May 6, 1993.

On June 10, 1993, the Trustee objected to USA Funds' Proof of Claim because the amount of the claim differed from the amount provided for in the Plan. The Trustee served USA Funds with its objection at the address listed on its Proof of Claim. The objection provided that if no response was filed, the claim would be allowed at the Plan amount. There was no response filed. On May 30, 1997, the Debtor received a discharge after completing all Plan payments, including payment of $13,250.00 to USA Funds.

Beginning in 2001, the Student Loan Creditors began collection efforts against the Debtor, asserting the outstanding obligation was in excess of $17,000.00 and that the obligation had not been discharged under the Plan. After various efforts to resolve the matter, the Debtor moved to reopen the case and filed a Motion for Violation of the Discharge, Contempt, Sanctions and Damages ("Motion").

JURISDICTIONAL STATEMENT

Jurisdiction is proper in this case pursuant to 28 U.S.C. § 157(b)(2)(L) and (O).

ISSUES

1. Is the Confirmation Order void?
2. If the Confirmation Order is not void, should sanctions be imposed on the Student Loan Creditors for violation of the discharge injunction?

DISCUSSION

USA Funds and DE have filed two identical briefs opposing the Motion. USA Funds and DE argue that the Confirmation Order is void pursuant to Fed. R. Civ. P. 60(b)(4) (made applicable in bankruptcy cases by Fed. R. Bankr. P. 9023) either because: (1) the Debtor did not give notice of the student loan discharge terms in the Plan in the same manner as if he had filed an adversary proceeding

seeking a hardship discharge under 11 U.S.C. § 523(a)(8), thereby purportedly denying the Student Loan Creditors of their constitutional due process rights; or (2) the bankruptcy court lacked subject matter jurisdiction to enter the Confirmation Order because the Plan contained so-called "illegal" terms which were inconsistent with the Bankruptcy Code's requirement that an adversary proceeding be filed in order to obtain a discharge of a student loan.

I address the argument regarding lack of subject matter jurisdiction first. This exact argument was rejected by the Ninth Circuit in *In re Pardee*, 193 F.3d 1083 (9th Cir. 1999). The facts in *Pardee* are almost identical to the facts of this case. In *Pardee*, the Chapter 13 debtors moved to enforce their discharge and to enjoin the student loan creditor's attempt to collect interest on the student loan obligation. The *Pardee* Plan contained a provision discharging the post-petition interest on their student loan debt. The student loan creditor had notice of the Plan and its discharge provisions but failed to object to the Plan. In *Pardee* the student loan creditor asserted, and the Ninth Circuit considered and rejected, the argument that if a Chapter 13 plan contains so-called "illegal provisions," that the Plan is nugatory and res judicata principles cannot prevent post-discharge collection efforts by the student loan creditor: "[t]his court has recognized the finality of confirmation orders even if confirmed bankruptcy plans contain illegal provisions." *Id.* at 1086, *citing Trulis v. Barton*, 107 F.3d 685, 691 (9th Cir. 1995); *Stratosphere Litig. LLC*

v. Grand Casinos, Inc., 298 F.3d 1137; 1143 (9th Cir. 2002).

Recently, the Ninth Circuit has issued a decision which casts some doubt on the continued viability of the holding in *Pardee*. *In re Enewally*, 368 F.3d 1165 (9th Cir. 2004), addressed the question of whether an order which approved a modification to a confirmed plan had a res judicata effect on the creditor. The *Enewally* court cited *Trulis v. Barton* and *Pardee* for the proposition that "it is beyond cavil that once a bankruptcy plan is confirmed, it is binding on all parties and all questions that could have been raised pertaining to the plan are entitled to res judicata effect." *In re Enewally*, 368 F.3d at 1173 (internal quotations omitted). However, one paragraph later the court states "although confirmed plans are res judicata to issues therein, the confirmed plan has no preclusive effect on issues that must be brought by an adversary proceeding, or were not sufficiently evidenced in a plan to provide adequate notice to the creditor." *Id.* Certainly, the above-cited language is broad enough to call the holding of *Pardee* into question. But the facts in *Enewally* are significantly different than here, or in *Pardee*. In *Enewally*, the debtor had commenced an adversary proceeding to obtain the "lien-stripping" result noticed in the Plan modification. Even more importantly, the modification which the debtor argued had altered the secured creditor's rights was approved by the bankruptcy court, *conditioned* upon the debtor prevailing in the adversary. On these facts it is clear that the plan

modification could not have a res judicata effect where the validity of the modification was specifically reserved for decision in the adversary. The essence of the *Enewally* holding on res judicata is that "a Chapter 13 plan confirmed while an adversary proceeding was pending would not have res judicata effect on the adversary proceeding." *Id.* Regardless of *Enewally*'s broad language, it did not overrule *Pardee*. Given the different fact pattern in *Enewally*, the similarity of the facts in this case to those in *Pardee*, and *Enewally*'s citation to *Pardee* as "good law," the Student Loan Creditors cannot prevail on their subject matter jurisdiction arguments in this case.

The second argument urged by the Student Loan creditors is that they were denied due process because the notice they received of the Plan was not equivalent to the notice required by Fed. R. Bankr. P. 7001(6), which requires the service of a summons and complaint in order to initiate a complaint to determine if a student loan debt should be discharged under 11 U.S.C. § 523(a)(8). The Student Loan Creditors argue that because *Pardee* does not directly address whether the student loan creditor's due process rights were violated by receiving notice under Fed. R. Bankr. P. 2002, instead of Fed. R. Bankr. P. 7016, that the holding in *Pardee* does not control the outcome of the case.

In re Repp, 307 B.R. 144 (9th Cir. BAP 2004), is a recently decided case very similar to this one, in which the majority agreed with the arguments made by the Student Loan Creditors. The majority found

that the minimal service requirements for Chapter 13 plan confirmations could not be used to elude the obligations to demonstrate undue hardship in an adversary proceeding. However, as pointed out by Judge Ryan's well-reasoned dissent, by deciding that a student loan creditor, who received notice under Fed. R. Bankr. P. 2002(b) of an adverse plan provision, is bound by that provision, the Ninth Circuit necessarily determined that the notice the creditor received satisfied due process requirements. *Id.* at 155.

In this case, USA Funds had several months notice of the Plan and its student loan discharge provisions. USA Funds filed a proof a claim before the Plan confirmation hearing. USA Funds received an objection to its claim shortly after the Plan was confirmed when it could have easily moved under Rule 9023 to revoke the discharge on the grounds that the Plan "illegally" discharged the balance of the Debtor's student loan obligations.[1] It did not do so. As Judge Ryan noted in his dissent in *Repp*, "[t]he idea that a creditor with more than 25 days notice of a plan containing a provision that adversely affects it can ignore the proceeding, sit on its rights, and then raise a due process argument years later, defies common sense." *Id.*; *In re Pardee*, 193 F.3d at 1086 (the student loan creditor "failed to take an active

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[1] A motion to alter or amend a judgment must be filed no later than 10 days after entry of the judgment. Fed. R. Bankr. P. 9023(3).

role in protecting its own interests" and so cannot, years later, expect the bankruptcy court or trustee to protect its interests.) As Judge Ryan also noted, due process does not place form over substance.[2]

In reaching this decision, I do not condone what the debtor did in this case. I agree with the approach adopted by Judge Haines in *In re Webber*, 251 B.R. 554 (Bankr. D. Ariz. 2000) and would not confirm a Chapter 13 plan that contained student loan discharge provisions similar to the provisions in this case. However, what is at issue in this case is not whether the Plan should have been confirmed, but the effect of the Plan's confirmation and the Debtor's receipt of a discharge after making all of the required Plan payments. The *Repp* decision ignores the fact that the holding in *Pardee* is based on the determination that the student loan creditors' failure to object after receiving notice of the Chapter 13 plan and its terms barred it from later attacking the terms of that order. It follows that if the notice the creditor received did not satisfy due process requirements, then the student loan creditors could not have been bound by the terms of the confirmed Chapter 13 plan; however, the Ninth Circuit held in *Pardee* that the creditor was

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[2] The due process requirement is satisfied with notice that is reasonably calculated, under all the circumstances, to apprise interested parties of pendency of action and to afford them the opportunity to object; it must be of such a nature as to reasonably convey the required information and to afford reasonable time for response. *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 US 306, 314 (1950).

bound, and therefore, the notice must have been sufficient to satisfy due process.

CONCLUSION

Because I find that because the Confirmation Order is not void, the Debtor's request that the Student Loan Creditors cease and desist all collection activity against the Debtor will be granted. However, because a number of courts agree with the position taken by the Student Loan Creditors, this is not an appropriate case for imposing sanctions for violation of the discharge injunction.[3] Moreover, the Student Loan Creditors have returned tax refunds previously withheld. Therefore, all remaining requests for relief in the Debtor's motion will be denied. An order consistent with the terms of this Memorandum Decision will be entered this date.

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[3] There is a split in the Circuits on the issue. Some courts hold that a confirmed Chapter 13 plan that purports to discharge student loan debt without the filing of an adversary proceeding cannot have res judicata effect on a creditor that did not object to the discharge provision at confirmation. *See e.g., In re Banks*, 299 F.3d 296 (4th Cir. 2002). However, other courts uphold the discharge even where there is a provision in a confirmed Chapter 13 plan that a student loan will be discharged upon completion of the plan and no adversary proceeding to determine the hardship discharge was filed. *See In re Boyer*, 305 B.R. 42 (Bankr. D. Kan. 2004); *In re Andersen*, 179 F.3d 1253 (10th Cir. 1999); *In re Patton*, 261 B.R. 44 (Bankr. E.D. Wash. 2001).

Dated this 12th day of August, 2004.

/s/ Eileen W. Hollowell
EILEEN W. HOLLOWELL
UNITED STATES
BANKRUPTCY JUDGE

Copy of the foregoing mailed this
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By: /s/ [Illegible]
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